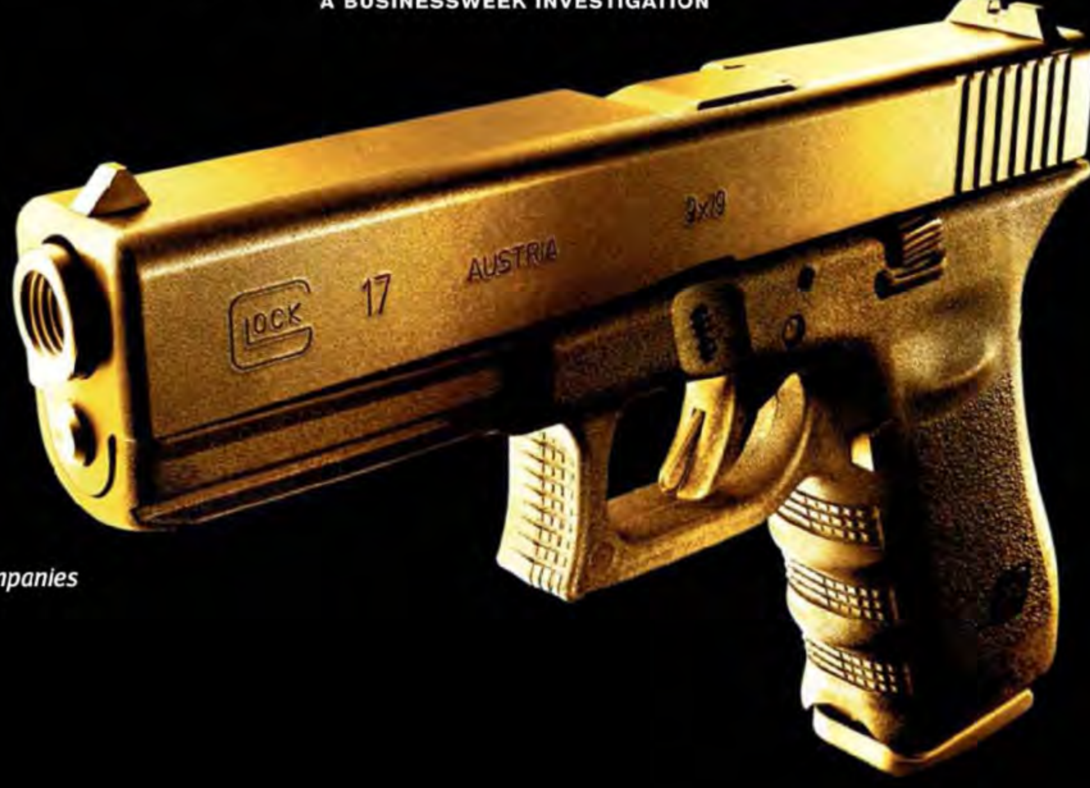
AMERICA'S MANUFACTURING CRISIS

BusinessWeek

GLOCK'S SECRET PATH TO PROFITS

It's the largest supplier of handguns to law enforcement in the U.S. But behind its success lies a troubling tale of business intrigue

A BUSINESSWEEK INVESTIGATION



SEPTEMBER 21, 2009
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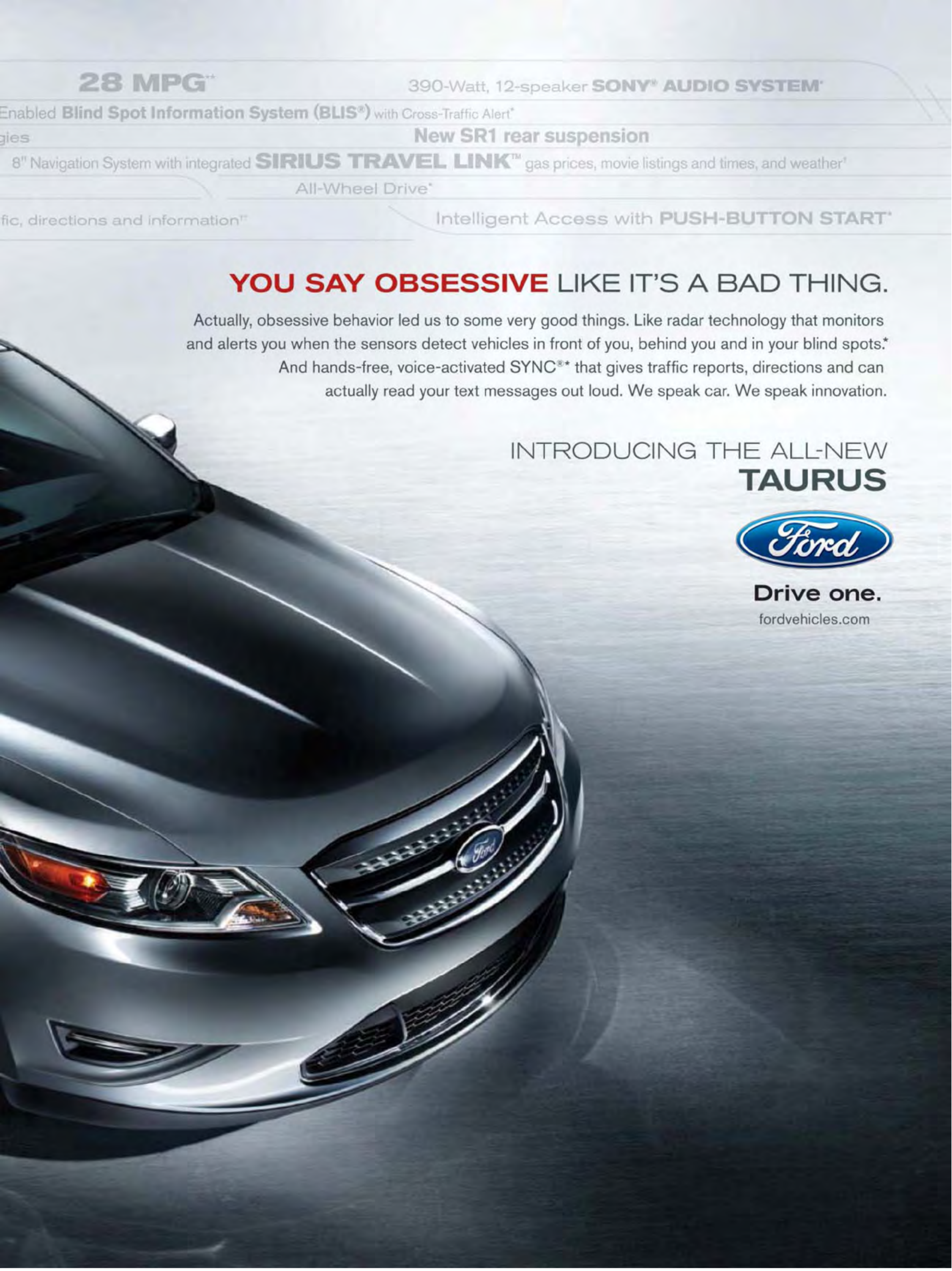
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Bridgelux CEO Swoboda wants to keep manufacturing in the U.S., but financial realities point to Asia

(COVER) ILAN RUBIN, DIGITAL IMAGING SHAKENA THORNTON/BW; (ABOVE) ERIC MILLETTE

IN DEPTH

GLOCK'S PROFIT MACHINE

036 | Austrian Gaston Glock shouldered past storied American brand Smith & Wesson to make his creation the best-known police handgun in the U.S., and perhaps the world. But behind the Glock phenomenon is a story rife with intrigue and allegations of wrongdoing. | BW |

CAN THE FUTURE BE BUILT IN AMERICA?

046 | U.S. high tech companies are developing products that could shake up entire industries. But unless the U.S. can restore its manufacturing base, those products will be built overseas. Smarter tax policies, low-cost loans, and special industrial zones could keep these well-paying jobs here. | BW |



ORACLE HAS CUSTOMERS OVER A BARREL

Larry Ellison's $7.4 billion bid for Scott McNealy's Sun is the most ambitious deal in a four-year buying spree that has doubled Oracle's revenues. But now customers worry its growing clout will lock in high prices and stifle innovation. | BW | PAGE 052



NO BIG FINANCIAL FIX

World leaders are talking bravely about reform, but any plan likely to emerge from the G-20 will be tepid, leaving the global financial system, and taxpayers, at risk. | BW | PAGE 022

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Jack and Suzy Welch are off this week.

(LEFT) PAUL SAKUMA/AP PHOTO



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006 | THE BUSINESS WEEK

EDITED BY HARRY MAURER & CRISTINA LINDBLAD



Obama speaking in Cincinnati on Sept. 7: Can he push through a health-care bill?

ECONOMICS & POLICY

ALL EYES ON WASHINGTON

It's a critical moment in **President Barack Obama's** first year. Congress returned to the capital on Sept. 8 to tackle a crowded and contentious calendar. First, second, third, and maybe even fourth on the list was health care, of course. The stalled debate over reform has held up progress on most other issues and threatens to damage Obama politically. At press time, his Sept. 9 speech before Congress was expected to stress the measures legislators largely agree on and why they matter to everyone, as well as a defense of the controversial "public option." If Obama regains momentum on health care, Congress will find it easier to move ahead this fall on financial regulatory reforms, moves to reduce foreclosures, and the much-disputed cap-and-trade bill to lower carbon emissions.

THE BONUS BATTLE

Politicians again have bank bonuses in their gun sights. On Sept. 5, the **Group of 20** finance ministers meeting in London opined that payouts should be doled out over longer periods and traders should receive nothing if their investments go belly-up. The leaders, though, rejected calls from France and Germany, which want to set caps on remuneration. The group also called on banks to conserve more cash on their books to cushion unforeseen losses but couldn't agree on details. Both issues will be on the agenda later this month when G-20 heads of state reconvene in Pittsburgh, but the discord is such that probably no hard decisions will be made.

NAUGHTY AIRBUS?

This dogfight isn't over by a long, long shot. Five years after a U.S. complaint was filed, the **World Trade Organization** issued an interim ruling on Sept. 4 that European governments lavished



(FROM TOP) CHARLES DHARAPAK/AP PHOTO; REMY DE LA MAUVINIERE/AP PHOTO

illegal subsidies on Airbus parent **European Aeronautic Defence & Space** for the **A380** passenger jet. That could help **Boeing** and Washington object to other funding for Airbus and theoretically could force EADS to repay billions in past aid. But the WTO is scheduled to rule next year on a countercomplaint alleging unfair U.S. aid to Boeing, and a final decision on the EADS penalties is probably years away. Still, some U.S. lawmakers will try to use the preliminary finding to help Boeing wrestle an Air Force contract from a rival U.S.-European team bidding to supply modified Airbus planes as refueling tankers. And the army of lawyers deployed by both sides will keep on raking it in.

▸ "Airbus, Boeing: The Fight Isn't Over"
businessweek.com/magazine

MEXICO'S CREDIT RISK

Will Mexico suffer the indignity of a downgrade? Unless Congress quickly cuts runaway spending and raises taxes, the nation's nine-year-old investment-grade credit rating could slip a notch as early as October. **President Felipe Calderón** on Sept. 8 sent his 2010 budget to Congress, saying it calls for a "drastic and unprecedented adjustment" in spending. Outlays have risen fast in recent years, fueled by fat oil export revenues. But sliding crude prices, a decline in oil production, and an expected 7.7% plunge in GDP this year have left the Treasury scrambling to trim a projected 3% budget deficit, up from 2.1% in 2008. Rating agencies **Fitch Ratings** and **Standard & Poor's** (like *BusinessWeek*, a unit of **The McGraw-Hill Companies**) both have negative outlooks on Mexico.



The WTO says that Airbus got illegal subsidies on the A380

STRATEGY

CELL GIANTS HOOK UP

Orange, shake hands with **T-Mobile**—but just in Britain. **France Telecom** and **Deutsche Telekom** said on Sept. 8 that they'll blend their British mobile operations in a 50-50 joint venture that will vault them to No. 1 in the market. Other such moves may follow as European operators look to share the cost of upgrading their networks for the mobile Internet. But regulators may squawk if they think the dealmaking leaves consumers with too few providers to pick from.

▸ "France Telecom, Deutsche Telekom Create UK JV"
businessweek.com/magazine

DOWNSIZING A BANK

Once-aggressive **Royal Bank of Scotland,** now 70% owned by British taxpayers, is slashing costs wherever it can. On Sept. 8, Reuters reported that the bank has

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PCWorld

Sprint tested as the most reliable 3G network overall among U.S. carriers in a recent 13-city 3G performance test conducted by *PC World.*

Coverage not available everywhere. Data plan required. Connectivity dependent upon capability. The 3G Sprint Mobile Broadband Network reaches over 253 million people. Offer not available in all markets/retail locations or for all devices/networks. Other restrictions apply. See store or sprint.com for details. *PC World's* tests included 13 major cities with more than 20 tests per city from all regions of the country for each provider's 3G service. Testing was one minute in duration, and network performance can be highly variable from neighborhood to neighborhood. ©2009 Sprint. Sprint and the logo are trademarks of Sprint. Other marks are the property of their respective owners.

008 EXECUTIVE SUMMARY



Tasty: But Cadbury quickly rejected Kraft's bid

hired Goldman Sachs to broker a sale of **RBS Aviation Capital,** one of the world's biggest aircraft leasing outfits, with almost 400 planes and operations from New York to Hong Kong. The unit is unlikely to fetch anywhere near the $8 billion it's valued at, since similar assets are already on the market but haven't found any enthusiastic buyers.

THE U.S. DROPS

Global Competitiveness Rankings

COUNTRY	2009 RANKING	2008 RANKING
Switzerland	1	2
U.S.	2	1
Singapore	3	5
Sweden	4	4
Denmark	5	3
Finland	6	6
Germany	7	7
Japan	8	9
Canada	9	10
Netherlands	10	8

Data: World Economic Forum

SWEET ON CADBURY

A bidding war in a candy store: That's what **Kraft Foods'** surprise $16.7 billion offer for Cadbury could turn into. The British confectioner quickly spurned the Sept. 7 bid, and analysts expect Kraft, the world's No. 2 food purveyor after Switzerland's **Nestlé,** will have to come up with more sugar. A deal would create a candy company with 15% of the global market, matching **Mars,** which acquired gum giant **Wrigley** in 2008. Other possible players include Nestlé and **Hershey's,** which could team up to avoid antitrust issues, with the Swiss company taking Cadbury's gum brands, such as **Trident,** and Hershey's keeping the chocolate. Analysts pointed out that Kraft's lofty debt level could prevent it from tossing more cash into the deal recipe.

"Cadbury's Key Ingredient: Gum" businessweek.com/magazine

TECHNOLOGY

SETBACKS FOR GOOGLE

Pssst—contrary to popular belief, Google isn't irresistible. The search behemoth lost yet another high-profile executive on Sept. 6 when the head of its Chinese operation, **Kai-Fu Lee,** announced he's quitting. He plans to create **Innovation Works,** a high-tech incubator in China. The departure is seen as a blow to Google's effort to end its also-ran status behind local leader **Baidu.** On another front, Google offered relatively minor concessions to European regulators grumpy about its plan to digitize millions of out-of-print books. Google's settlement of a class action brought by U.S. authors and publishers is scheduled for a Manhattan federal court hearing on Oct. 7.

"Interview: Google China's Kai-Fu Lee Debuts Innovation Works" businessweek.com/magazine

FINANCE

CUOMO VS. BOFA

Reason No. 43 Why **Ken Lewis** Wishes He Hadn't Bought **Merrill Lynch:** Frustrated by what looked like efforts to stonewall, **New York Attorney General Andrew Cuomo** on Sept. 8 threatened to bring securities fraud charges against **Bank of America** executives over their "failures" to disclose Merrill's mounting losses and bonus payouts ahead of a key shareholder vote last December. In a letter to the Charlotte (N.C.) bank, a top Cuomo aide chided BofA for "hindering" investigators from

Google's Lee announced he's quitting to start a high-tech incubator in China



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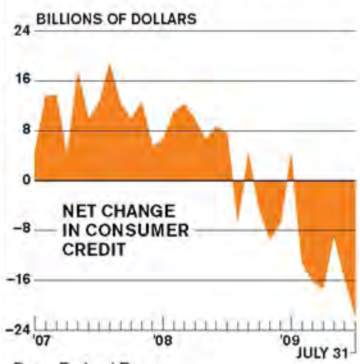
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interviewing the bank's attorneys after saying it relied on their opinion that BofA didn't have to disclose any more than it had already. In a response, the bank lambasted Cuomo for making "spurious and false allegations" and said it has met all disclosure obligations.

GIVE ME SOME CREDIT



Data: Federal Reserve

THE BRUISED DOLLAR

Enough already with the flight to safety. The U.S. dollar fell almost to a one-year low on Sept. 9 as investors, who fled to the greenback during the financial crisis, decided they're readier for riskier plays. The **Dollar Index,** which tracks the value of the buck vs. a basket of six major currencies, is down more than 13% since its March high, according to Bloomberg. And who could be more pleased than gold bugs, who drove bullion north of $1,000 an ounce in intraday trading on Sept 8. Gold closed that day at $995.40, an 18-month high.

LEADERSHIP

YOU'VE GOT ... A NEW BOSS

There was a time when **AOL** e-mail ruled the world—remember "You've got mail"? Looking to pump some pizzazz into its fading service, the portal on Sept. 8 tapped **Brad Garlinghouse,** the **Yahoo!** alum who helped that company's e-mail grab the No. 1 spot in the U.S. Garlinghouse will oversee AOL's e-mail and instant messaging products and its Silicon Valley operations. He's best known for an internal memo dubbed the "peanut butter manifesto," in which he candidly took Yahoo's top brass to task for spreading efforts too thinly across many scattered businesses. Sharp focus would certainly be a thing of beauty to freshly minted **AOL CEO Tim Armstrong,** who's working to reverse his company's fortunes as it prepares to be spun out from parent **Time Warner** later this year.



Garlinghouse helped Yahoo!'s e-mail service to grab the No. 1 spot in the U.S.

"AOL: We've Got Garlinghouse"
businessweek.com/magazine

IDEAS ARE EMERGING MARKETS HEADED FOR A GOLDEN AGE?

"Volatile" is one of the clichés used to describe emerging markets. And no wonder, given the roller-coaster performance that developing country economies turned in during the 1980s and 1990s.

But whipsawed investors can take heart from an article in the September issue of the *Far Eastern Economic Review*. In it, **UBS** economist **Jonathan Anderson** argues that the developing countries are poised for a new golden era that in many ways resembles the 1960s and '70s. During those years, growth averaged 6% a year, compared with less than 4% for the U.S. and Europe. Then came the 1980-82 recession, and for the next couple of decades the emerging world actually sank.

Developing countries are weathering the downturn much better this time, confounding expectations that as demand for their exports dried up, growth would be thrown off track. Why is that? Because they steered clear of leverage. While industrialized nations were piling on debt, most countries in the developing world—particularly governments—were paring back. UBS expects emerging markets to grow at an average rate of 5% to 6% over the next five years, compared with an anemic 1.5% to 2% for advanced economies.

Far Eastern Economic Review



Jakarta shoppers: Emerging markets may grow fast

(FROM TOP) NEAL HAMBERG/BLOOMBERG; DIMAS ARDIAN/GETTY IMAGES



FEWER FIRINGS, BUT JOBS WILL STAY SCARCE

Companies, still wary of weak consumer demand, aren't doing much hiring. It's a trend that could keep unemployment high for the first year of the recovery

The news from the job front continues to be "less bad." Payroll losses in August, totaling 216,000, were the least in a year, continuing the trend of progressively smaller declines. Now, with an economic recovery apparently under way, some key questions are cropping up: When will payrolls start growing again? How strong will job growth be? And when will the jobless rate begin to come down?

If monthly job losses continue to ebb at the rate of the past several months, the drop in payrolls, which has eliminated 6.9 million jobs over 20 months, would come to a halt in December. That seems likely if improving expectations for second-half economic growth are on the mark. Many forecasters are upping their projections into the 3%-to-4% range, a pace historically consistent with rising payrolls.

15.4

Median number of weeks unemployed in August, down from a record 17.9 weeks in June

Data: Labor Dept.

But then what? One concern is that poor job growth has been the norm during the last two recoveries. To some extent, that pattern reflects the tendency of mild recessions to be followed by weak recoveries. In the first year after the mild 1990-91 downturn, growth in real gross domestic product was only 2.6%, and payrolls did not turn up until three quarters after the recession ended. The economy grew only 1.9% after the 2001 downturn, which is barely visible in the GDP data, and jobs didn't pick up for seven quarters afterward.

On the flip side, deep recessions like this one have tended to be followed by strong recoveries. However, job growth in the current upturn will face a special set of headwinds, as lingering credit constraints and debt-burdened consumers limit growth. After the severe 1973-75 and 1981-82 recessions, first-year GDP growth shot up 6.2% and 7.7%, respectively, and payrolls grew 3.1% and 3.5%. If job growth were to match that pace in the coming year, monthly gains would average more than 350,000, which seems highly unlikely.

For one thing, job losses in this recession have much more frequently been the result of hiring cuts rather than layoffs. Monthly payroll losses, averaging about 300,000 in recent months, indicate a net result of about 3.7 million total hires per month and about 4 million job separations of all types. In the 12 months ending January 2009, as payroll declines became progressively worse, the rate of separations held about steady, but the rate of hiring plunged.

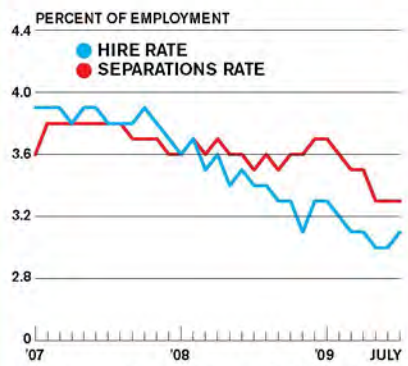
Economists at JPMorgan Chase note that in the jobless recoveries after the last two recessions, the rate of firing subsided, as in previous recoveries, but businesses did not pick up their hiring rates until far into the upturn. Unfortunately, the same pattern may be shaping up this time. Although monthly payroll losses have been getting smaller since January, that easing has been the result of sharply fewer separations, while the hiring rate has continued to fall (chart).

Businesses will remain hesitant to hire as long as overall demand remains subdued, and that is almost certain to be the case in the coming year. Spending in the U.S. and elsewhere stabilized last quarter, but the lion's share of growth in the second half will come from companies replenishing their depleted inventories rather than from a resurgence in demand. Plus, businesses remain keen on cutting costs and keeping productivity high. Productivity, measured as output per hour worked, soared at a revised 6.6% annual rate last quarter, and another big gain is on tap for this quarter.

How might all this figure into the unemployment rate? Economic growth of 3% or better would be consistent with a topping out in the jobless rate, perhaps in the next few months. That growth rate would generate more than the 100,000 to 150,000 jobs per month needed to prevent joblessness from rising further.

However, based on past trends, a one-percentage-point drop in the jobless rate would require payroll gains of about 350,000 per month for a full year. Even at that clip, unemployment would still be about 9% at the end of 2010. That means the first year of recovery could be a tough one for both politicians and policymakers. | BW |

THE RATE OF HIRING VS. THE RATE OF JOB LOSS



Data: Bureau of Labor Statistics, IHS Global Insight

BRAD TRENT; CHART BY JOE RHAMES/BW

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Fraud has cost the banking industry over
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NUMBERS

ANOTHER YEAR OF PAIN AHEAD FOR MOST U.S. STATES

By Tara Kalwarski/Charts by Laurel Daunis-Allen

The financial health of U.S. states overall is expected to continue to decline in fiscal year 2010 because of revenue losses. Spending cuts in seven states, including Nevada and West Virginia, could exceed 10%. But areas that have felt less of the downturn's impact already are beginning to recover.

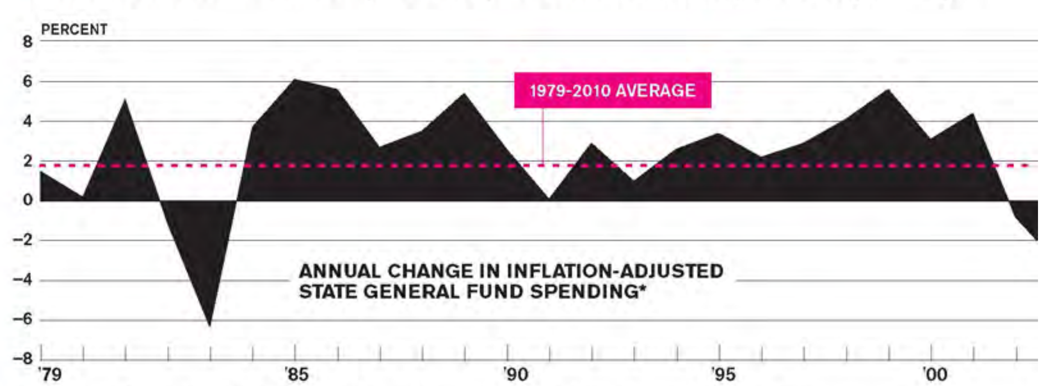
Hardest Hit: Michigan and Arizona have lost the most jobs as a percentage of total state employment over the past year.



*Seasonally adjusted; as of June 2009
Data: Bureau of Labor Statistics

STATE SPENDING: BACK TO THE '90s

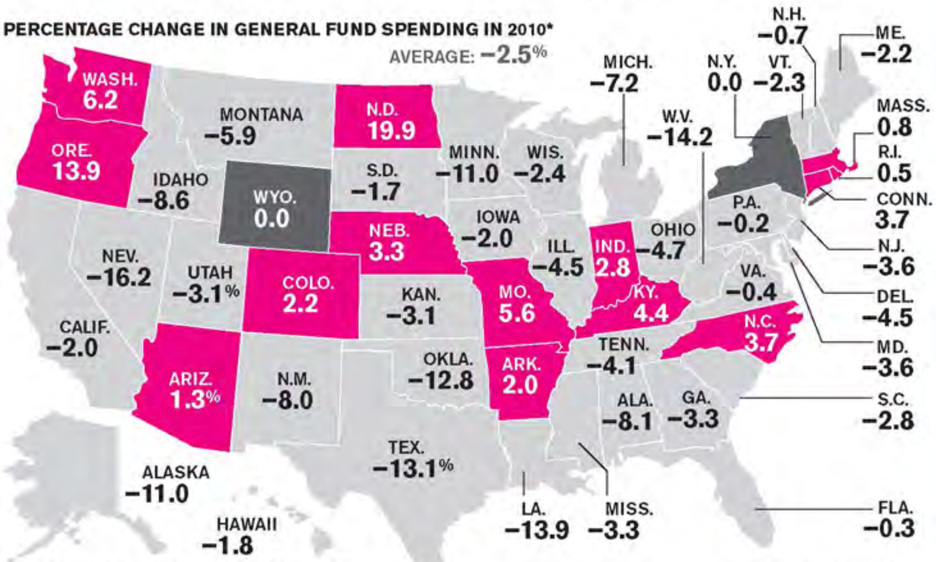
State general fund spending, adjusted for inflation, is expected to fall less in 2010 than in 2009. But in real terms outlays are likely to be lower than they were 10 years ago.



Data: National Association of State Budget Officers *Accounts for about 44% of total budget expenditures

Bright Spots: In fiscal year 2010, 14 state general fund budgets are expected to rise, with those of Oregon and North Dakota logging double-digit jumps.

PERCENTAGE CHANGE IN GENERAL FUND SPENDING IN 2010*



Data: National Association of State Budget Officers

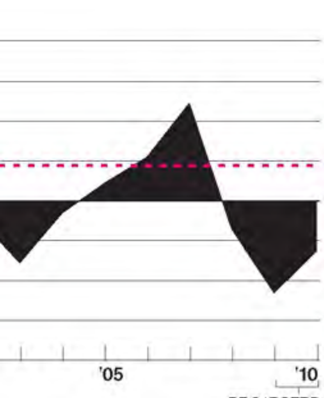
*Estimates for fiscal year

Holding Steady: State sales and personal income tax revenues are expected to increase in 2010 but will remain below 2008 levels.

STATE TAX COLLECTIONS IN BILLIONS*

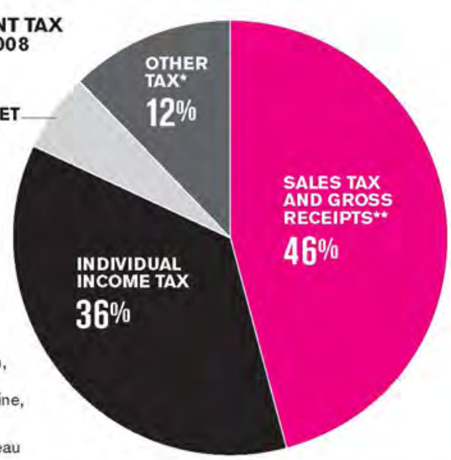
	SALES TAX	PERSONAL INCOME TAX	CORPORATE INCOME TAX
Fiscal Year 2008	$214.2	$276.2	$50.8
Fiscal Year 2009	$207.4	$257.8	$43.0
Fiscal Year 2010	$213.6	$261.1	$42.3

*Figures for fiscal 2010—which began on July 1 for many states—are projections, while those for 2008 reflect actual tax collections and for 2009 the current estimates.
Data: National Association of State Budget Officers



Revenue Sources: Individual income taxes make up just over a third of total state tax revenue.

STATE GOVERNMENT TAX COLLECTIONS IN 2008



* Includes licenses, death, gift, and property taxes
** Includes taxes on gasoline, alcohol, and cigarettes

Data: U.S. Census Bureau

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BLACKROCK'S LARRY FINK SIZES UP THE MARKET

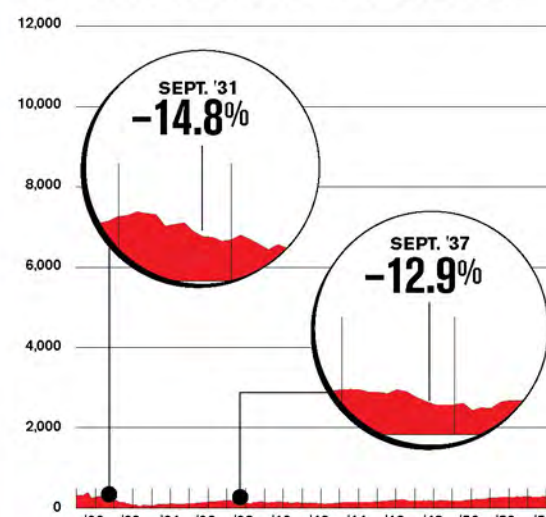
September, it is often said, is the cruelest month on Wall Street. With the markets and business focused on what looks like an uncertain fall, will that be true this year? BlackRock CEO Larry Fink, whose firm will control close to $3 trillion when its purchase of Barclays Global Investors is closed, is cautiously optimistic about the performance of the stock market in the near term.

MARIA BARTIROMO
There's obviously lots of exuberance in the market. How do things feel to you?

LAURENCE D. FINK
Things are healing. You know we had, essentially, five months of total fear,

(TOP TO BOTTOM) BRAD TRENT; MATTHEW FURMAN

SEPTEMBER CAN BE CRUEL



Data: Bloomberg

starting with the nationalization of Freddie Mac and Fannie Mae and the failure of Lehman Brothers. Then going into the first part of this year, we just went from worse to worst. Now people are more confident that we've seen the bottom. But it will be another two or three months until we can be sure that the economy is really on a stable footing.

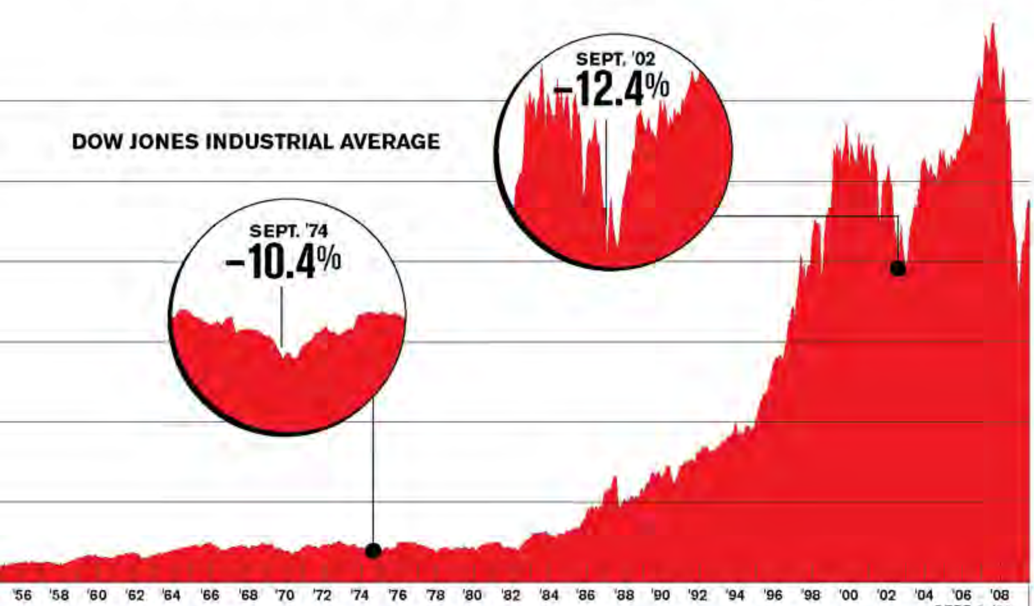
Is the market – and the money that's been on the sidelines and is moving into the market – expecting too much?
I don't think so. There's so much money sitting and earning zero or close to zero. I think it doubtful the market can go up another 20%, but I believe we can go a little higher because there's so much liquid money. I don't believe the Federal Reserve is going to raise interest rates anytime soon, and so putting some money to work in equities is probably a responsible thing to do.

How are you investing right now?
We are constructive in equities. But I believe for the markets to do substantially better, we're going to have to see validation in the economy. And I don't think we're going to see that much of it in the near term. We are still in an environment where employment is going to struggle. We believe unemployment will be over 10%. I think CEOs are reluctant to hire because our memories are still pretty vivid about how bad it was just five months ago. And there is great uncertainty among CEOs and management teams about raising the income tax, about cap and trade, and about how the health-care bill will end up. And we believe the next wave of employment problems is going to be in state and local governments. You know, people ask me, "Is this a V economy? Is this a U economy?" And I like to call it the swish economy. It's almost like the Nike swish. It's just going to go up very modestly for the next few years. It's going to be better, but it's not going to be what we expect after a very severe recession.

NYU economist Nouriel Roubini would say it could be double dip because of worries about the exit strategy of the Fed and what happens with inflation or commercial real estate.
I think inflation could be a problem out two or three years, but I'm not terribly worried about that at the moment. In terms of commercial real estate, bubbles generally blow up because people are not paying attention to the problem. There is no one who's not paying attention to commercial real estate. So I don't think it will be the cause for another dip in the economy.

What do you worry about?
I worry about the dollar. I worry about our competitiveness as a nation. Look at what Brazil is doing now in terms of lowering taxes for companies and building long-term infrastructure projects. You see what's going on with the stimulus package in China. Almost its entire $700 billion stimulus package was towards infrastructure. And I see other countries spending more time working with business in building a better and brighter future. We are still too focused as a nation politically and in business on the next quarter, and we're not responding to the long-term issues of this country.

Do you think we need an agency to oversee consumer credit?
I think there's a great need to protect consumers more than we've done in the past. Mortgages are a great example. We had a mortgage system that was out of control. I believe we need a system in which we protect our citizens so they feel they're not being misled. We'll have a better, more robust economy once consumers start feeling they are protected.



MANAGING FORWARD THE RESET ECONOMY

Getting ready for the post-recession world

How have things changed in the year since the Lehman failure?
Well, we have more government involvement and a rising populism about the nature of the financial system. We have a more conservative business environment. We have an investment community that feels burned by so many poor investments over the last few years. But there are many positives from the change. I believe our system is healthier now. Our banking system is going to be much healthier and less reliant on leverage. But probably the most important change is to our psyche. I think today people have a much deeper appreciation of liquidity, a much deeper appreciation of leverage. Because of the nature of where we are, people are focusing on longer-term investing. | BW |

Maria Bartiromo is the anchor of CNBC's Closing Bell and writes the blog, Maria Bartiromo's Investor Agenda, at http://investoragenda.cnbc.com



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ILLUSTRATION BY KEITH NEGLEY

BRITAIN'S NEW SCROOGES THREATEN ITS ECONOMY

A new mood of austerity is sweeping Britain. In recent months, savings rates have more than doubled while spending on big-ticket items such as flat-screen TVs has declined at the fastest rate in decades. What's more, official statistics released on Sept. 1 show Britons' $2.4 trillion in personal debt has fallen for the first time since 1993.

The newfound frugality should be cause for celebration. For years, economists have felt British consumers—who have the world's highest debt levels relative to discretionary income (more than a third higher than Americans')—should rein in spending. Many pointed to the thrifty habits of consumers in France and Germany, where double-digit savings rates and a general aversion to credit limited the excesses of the pre-credit-crunch era.

But that was before the Great Recession. Now policymakers fret that Britain's penny-pinching may do more harm than good. "The lack of spending is holding back the recovery," says Andrew Goodwin, an adviser to the Ernst & Young ITEM club, an economic forecasting group.

The economy is in dire need of a boost. Britain's reliance on the financial industry made it particularly vulnerable when global credit markets collapsed. Second-quarter gross domestic product contracted 5.5% year on year, and the jobless rate—usually among the lowest in Europe—is at 7.8% and could soon top 10%. With banks struggling, consumers were expected to come to the rescue. Last year Prime Minister Gordon Brown cut the value-added sales tax to 15%, from 17.5%, in hopes of persuading citizens to open their wallets. Other incentives, including a successful $495 million cash-for-clunkers program, followed.

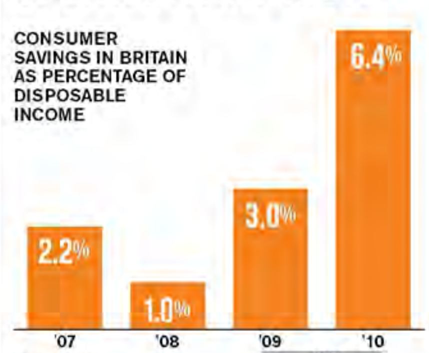
But aside from a slight bump in spending at the start of this year, consumers don't appear to be parting with their money. Nonfood sales for June to August, for instance, fell 0.7% year over year. And fears that the recession will continue well into 2010 have kept consumer confidence at a 12-month low. "People are scarred from recent experiences," says Alan Smith, managing director at financial adviser Capital Asset Management. "They want to clear debt as quickly as possible."

Total personal borrowing in July—loans, credit cards, and mortgages—fell $1 billion as Britons took advantage of historically low interest rates to rejigger their finances.

The increased saving should help Britain's economy in the long run. With personal indebtedness at 183% of disposable income (vs. U.S. consumers' 134%), the new thriftiness will put houshold finances on a more even keel. In the near term, "the adjustment to less debt will be severe," says Jamie Dannhauser, economist at London's Lombard Street Research. "But it's exactly what Britain has to do."

—Mark Scott in London

SALTING AWAY MORE



Data: UBS

WHERE LANDING A JOB IS EASIEST

Looking for work? Head for Des Moines, one of the most attractive cities for job seekers, according to a new survey by SimplyHired.com, a Web site that aggregates online job listings. The company recently analyzed 3 million public- and private-sector job postings—measuring the number of job seekers interested in each opening to determine the most and least competitive U.S. markets. Along with Des Moines, home of such insurers as Principal Financial Group, other employment havens for both blue- and white-collar workers include Washington—Uncle Sam is still hiring—and Omaha, home to Warren Buffett and food giant ConAgra.

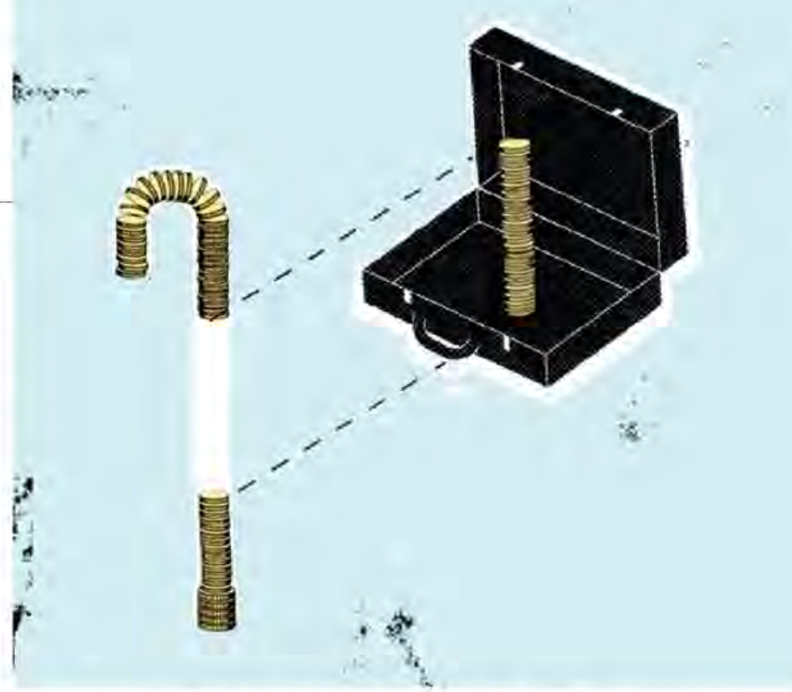
Does a dearth of candidates in Des Moines (five for every job opening, vs. 46 in Detroit) mean employers are having trouble staffing up? "We don't have a difficult time filling positions," says Kevin Elsberry, director of human resources at Mercy Medical Center, which will hire about 800 new employees this year. *–Matthew Boyle*



Hundreds of applicants lined up—some camping out for days—for firefighter jobs in Miami last February

U.S. JOB MARKETS*	JOB SEEKERS PER JOB POSTING	UNEMPLOYMENT RATE AS OF JULY '09**
LEAST COMPETITIVE		
DES MOINES	5	5.5%
WASHINGTON, D.C.	5	6.2%
OMAHA	5	5.3%
W. PALM BEACH/FT. PIERCE, FLA.	6	11.3%
SALT LAKE CITY	8	6.0%
MOST COMPETITIVE		
DETROIT	46	17.7%
GRAND RAPIDS/KALAMAZOO	35	12.7%
MIAMI/FORT LAUDERDALE	29	10.8%
SACRAMENTO	28	11.8%
LAS VEGAS	26	13.1%

*Metropolitan statistical areas (can include other cities) **Preliminary
Data: SimplyHired.com, Bureau of Labor Statistics



STOCK OPTIONS, YES. PENSION COFFERS, NO

Last year big companies with employee pension plans put less into funding those promises than they spent on stock grants and options for executives, according to a recent study of S&P 500 companies. The research, published by *The Analyst's Accounting Observer*, found that the 358 companies with pension plans in the index put $39.5 billion into those programs while giving out stock grants and options worth $44.5 billion. That's despite an aggregate $283.6 billion shortfall in their pension coffers. Jack Ciesielski, who published the research report, says corporations must weigh the payoff from lavishing so much on managers, who bring "uncertain" returns, against the benefits from other spending. Pension obligations are legally binding. So if a plan remains underfunded, a company must eventually make up the difference—usually by borrowing or by diverting cash that could have gone into building the business. Among S&P 500 sectors, financials have the biggest gap, with $15.2 billion going to restricted stock and options vs. $6.4 billion into pension funds. Who spends more on pensions than on stock options? Industrials (a sector that is still strongly unionized), with $7.9 billion for future retirees and $3.8 billion for stock-based executive pay. *–Nanette Byrnes*

PHOTOGRAPH BY CARLOS BARRIA/REUTERS; ILLUSTRATION BY YAREK WASZUL

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NO BIG FIX FOR GLOBAL FINANCE

New regulations will be tepid—and will leave the global system at risk



By Theo Francis and Peter Coy

FINANCIAL REGULATION

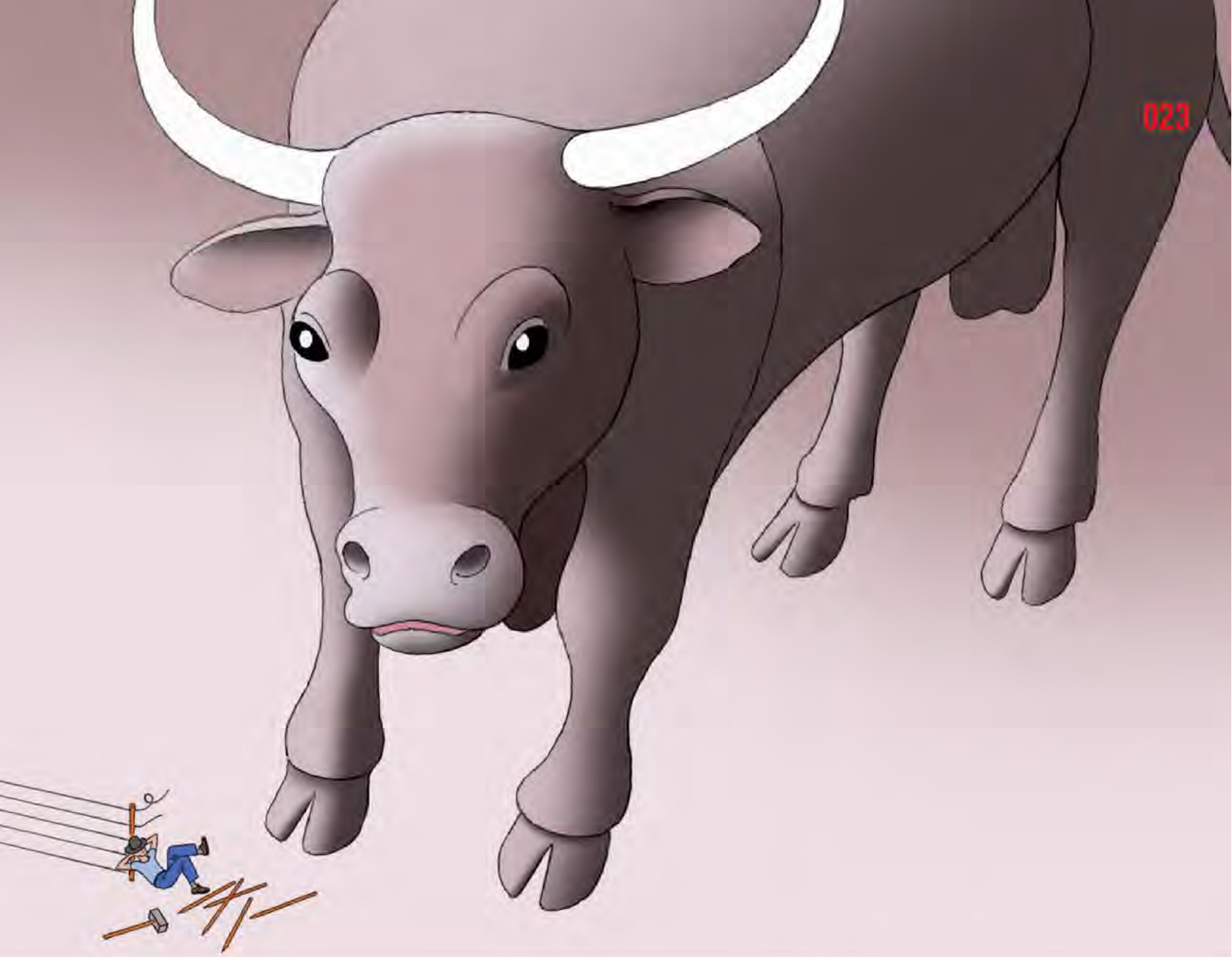
World leaders are talking bravely about fixing the global financial system. As the Group of Twenty nations head toward an important summit in Pittsburgh on Sept. 24-25, they are vowing to bang out a regulatory structure that will keep rich, careless bankers from once again driving their firms to ruin and then getting bailed out by taxpayers. Finance ministers and central bankers who met in London earlier this month reported "substantial progress in delivering our ambitious plan."

But their plan is far less ambitious than what some voices were advocating as recently as last spring. Bank lobbyists have fought back hard, and recent improvements in the global economy and financial markets have robbed momentum from the reformers. What's more, truly ensuring change on a global scale would probably require a single international regulator with power to intervene in local affairs. Yet there is little appetite for that among the G-20, which includes the major industrialized countries as well as China, Brazil, and other developing powers.

The likely result? A package of worthy but lukewarm reforms that leave the global financial system—and taxpayers—exposed to another costly bust some years down the road. "We're not going to have a revolution," says Edwin M. Truman, a senior fellow at the Peterson Institute for International Economics who advised Treasury Secretary Timothy Geithner before G-20 meetings last spring. "The question is to what extent you're going to have, over the next year, a substantial evolution."

International and U.S. proposals on the table target the hot topics: increasing capital requirements, corralling the "shadow banking system" of nonbank lenders, and otherwise trying to ensure that risk doesn't balloon out of control. But in most cases they rely on the kinds of tools that failed the last time around, when supervisors proved less than vigilant, turf squabbles impeded regulation, and fears of foreign competition led governments to yield to industry demands for a lighter touch.

In the chaotic months following the bankruptcy filing of Lehman Brothers on Sept. 15, 2008, few ideas seemed too extreme for consideration. Break up the giant banks. Regulate the survivors like utilities. Ban casino-like bets on the possibility of default by corporate borrowers. Prohibit credit-rating agencies from being paid by the agencies they rate. Above all, build a mechanism so that even huge multinational banks could fail without jeopardizing other firms and national economies.



GUY BILLOUT

The G-20 plan doesn't do any of that. It focuses on bolstering the cushions of capital that financial firms must hold, making sure they have the liquidity to survive a cash squeeze, and strengthening the supervision over them. By the end of this year global regulators are supposed to come up with a plan for banks to build up capital buffers in good times that they can draw down in bad ones. That would discourage banks from overlending in booms and choking off credit in busts, as they tend to do. Unfortunately, experience shows that banks are good at getting around tougher capital standards or persuading regulators to ease them.

The G-20 nations aren't even seeking fundamental restructuring. Banking firms could continue collecting government-insured deposits with one hand and, in other subsidiaries, make risky bets on the market—though the cost of doing so could rise.

INCREMENTAL CHANGE

The Administration's financial regulation plan is evolutionary, not revolutionary

"TOO BIG TO FAIL" INSTITUTIONS

Rather than break up big banks, the Administration wants to regulate them more tightly and require the biggest to carry extra-thick capital cushions.

DERIVATIVES

Officials want to shift most trading in the financial instruments to new exchanges. But some contracts could continue to trade over the counter, where there's less scrutiny.

CONSUMER PROTECTION

The Administration's plan to consolidate consumer protection in a single new agency faces opposition from the industry and from regulators jealous of their turf.

Data: *BusinessWeek*

To succeed, rules also must be applied consistently around the world, but gaps are appearing in European and U.S. officials' united front. European regulators want to establish explicit boundaries for bankers' pay and tie capital requirements to the risk of an institution's underlying assets. U.S. officials, on the other hand, are resistant to strict pay limits and are focused on the capital requirements

of the biggest and most important institutions.

Scariest of all, there is still no procedure for countries to share responsibility for the takeover and resolution of a failing multinational financial firm like Lehman or insurer American International Group. Another uncontrolled failure today could set off a global domino chain of failures. Says Raghuram G. Rajan, the former chief economist at the International Monetary Fund who currently teaches at the University of Chicago's Booth School of Business: "The difficulty of international dialogue means [establishing a procedure] will take forever, by which time people will have forgotten and something much more diluted will have come out."

International coordination isn't the only stumbling block. The U.S. is moving gingerly even on purely domestic issues. For example, regulating insurance conglomerates like AIG is proving tricky. Under the reorg plan being pushed by Geithner, U.S. insurers would continue to operate under a patchwork of state regulation, though the largest would get additional scrutiny from the Federal Reserve or a committee of federal regulators.

Officials in the Obama Administration also considered consolidating the Securities & Exchange Commis-



LESSONS FROM LEHMAN'S FAILURE

Financial experts and regulators opine on what we've learned in the year since the investment bank collapsed



SHEILA BAIR

Chair of the Federal Deposit Insurance Corp.

"We need an orderly resolution process for closing large nonbank financial institutions, as the FDIC now has for banks. This is essential to protect the broader economy from damage when a large institution gets itself into trouble."



JEREMY SIEGEL

Professor of Finance at the University of Pennsylvania's Wharton School and author of *Stocks for the Long Run*

"We learned from the mistakes of the 1930s, in particular the mistakes mentioned by Milton Friedman in his critique of Fed policy during the Great Depression. Friedman thought that the Fed should have provided liquidity and reserves at that time. Current Fed Chairman Ben Bernanke is taking his strategy page by page out of that critique. When I look at the situation—the liquidity measures, the backstop to the banking system—that sort of confidence is the primary reason the credit markets have improved."

ELIZABETH WARREN

Harvard Law School professor and chair of the Congressional Oversight Panel

"If there's no credible threat of liquidation, then capitalism doesn't work—and that's true whether we're talking about peanut butter manufacturers or hedge funds. After so many bailouts, it is critically important to design a system in which the winners survive and the losers get flushed away."



DOUGLAS REDIKER

Director of New America Foundation's Global Strategic Finance Initiative and former Lehman Brothers investment banker

"Any argument that Lehman's collapse served the positive purpose of letting the world financial system participants know there was a risk to be had, that message lasted 24 hours. We may now have the inverse message: There are banks that are too big to fail."

sion, which oversees the securities market, and the Commodity Futures Trading Commission, which polices futures and commodity markets. But they concluded it would take too much political capital to buck the congressional agriculture and financial committees that split responsibility for the agencies—and that enjoy the campaign contributions that follow the oversight. Now the proposal calls for just one of more than a half-dozen federal financial regulators to disappear.

The Administration's goal of consolidating all financial consumer protection in a single agency—perhaps its boldest proposal—is running into a buzz saw of bureaucratic infighting and industry lobbying. "Our strategy is to kill it," says one lobbyist for the financial services industry.

Furthermore, banks selling complex derivatives—essentially financial bets—would be free to continue writing "custom" contracts under the Geithner plan. That would sidestep many of the protective mechanisms built into the brand-new exchanges and clearinghouses designed to temper the risk of such instruments.

It's not just bank-hating liberals who are concerned. R. Glenn Hubbard, who was President George W. Bush's chief economic adviser from 2001 to 2003 and is now dean of Columbia University's business school, is generally reluctant to interfere in the markets more than necessary. Yet he says he's disturbed by what he sees now. Hubbard favors stronger measures to improve the security and transparency of derivatives trading. "Ironically, the Obama Administration is less tough on Wall Street than many market participants and academics who have recommended reform," Hubbard says.

To be sure, the plans in the works are better than nothing. One clever idea proposed in the Treasury documents is to require financial firms to sell a big issue of bonds that would automatically convert to equity if money were tight. Such securities would relieve the firms of their debt payments and replenish their capital even in panicked markets. Another idea Geithner favors is to force big firms to draw

(CLOCKWISE FROM LEFT) PHOTOGRAPHS BY SUSAN WERNER; MELISSA GOLDEN/BLOOMBERG; CHIP EAST/REUTERS; NONE



In the face of an unstable economy and an uncertain future, businesses are concerned about how they will navigate the coming months and importantly, how to identify and plan for a new set of risks.

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up plans that regulators could use to dismantle the institutions. (One reason Lehman Brothers was so hard to shut down was that it had more than 600 subsidiaries.) And the new capital rules may dissuade banks from collecting deposits while participating in risky trading activities. They would have "no choice" but to separate into "specialized entities," Karen Shaw Petrou, co-founder of consultancy Federal Financial Analytics, predicted in a Sept. 4 report. Douglas J. Elliott, a former JPMorgan Chase banker now at the Brookings Institution, generally praises the reforms: "If you believe the single biggest problem was that everyone got careless, then you'll be happier because everyone will have to be more careful."

Trouble is, the reforms are weaker than expected, and they're likely to be watered down even more by the time they're passed. As markets recover, lobbying for laxer regulation will intensify. Already financial engineers are at work on an array of insurance, derivative, and other products designed to exploit loopholes in the new regulatory regimes. Meanwhile, the biggest financial firms have only gotten bigger and harder to control. The Economic Policy Institute notes that the four biggest U.S. banks have about 45% of industry assets, up from around 27% in 2003.

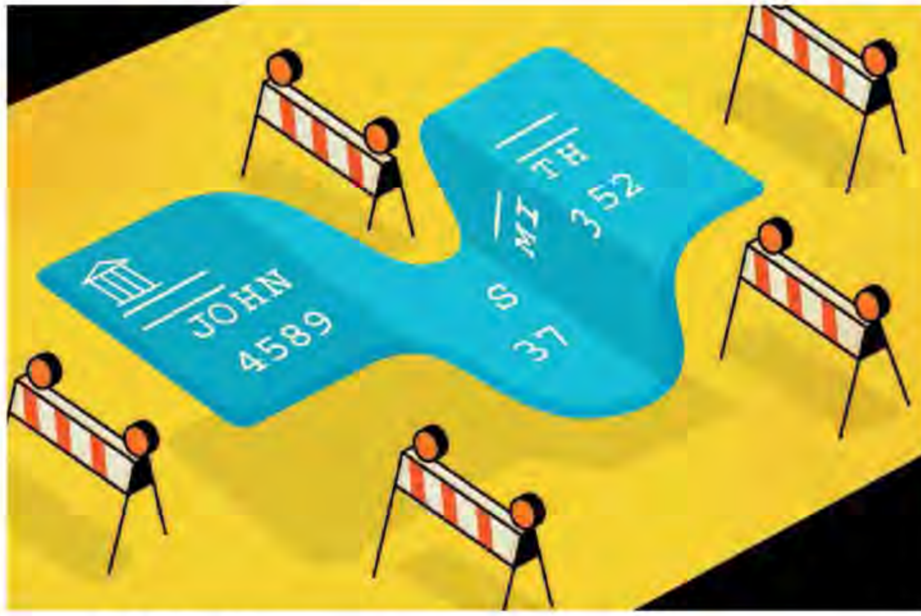
Reform? Yes. Fundamental change? Not by a long shot. |BW|

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The Regulatory Report Card
Robert Litan, a former budget official in the Clinton Administration, takes a hard look at President Obama's proposed financial reforms in a recent issue of *Lombard Street*, a new online newsletter that covers regulation. His assessment: "On the proverbial 1-10 scale, I give the plan an '8.'"

To read the full commentary, go to **http://bx.businessweek.com/financial-regulation/reference/**



GIVING CREDIT-CARD REFORMS THE SLIP

Card issuers are already proposing new fees and thinking up ways to subvert interest-rate restrictions

By Ben Levisohn

FINANCIAL REGULATION

New credit-card rules, designed to curb the industry's abusive practices, went into effect a few weeks ago. But already lenders have found ways to get around the regulatory roadblocks—moves that may cost consumers in the end. Says Gwenn Bézard, head of research at consultant Aite Group: "The industry was against the spirit of the act."

The reforms are sweeping. The Credit Card Accountability, Responsibility & Disclosure Act of 2009 covers everything from billing to fees. The first wave of changes hit in late August, with another to follow early next year. For all their worries, credit-card companies may not see dramatic losses. In fact, the spate of interest rate hikes on credit cards, driven in part by the recession, may boost profits. Says Gene J. Truono, managing director at BDO Consulting: "Issuers always reinvent themselves."

Companies have already rethought rates. Under the new law, issuers can't raise them without 45 days' notice. But there's a loophole: The rules don't apply to variable-rate cards, with rates that float up and down. That's why companies are moving more consumers into such cards, whose rates are likely to soar from their record lows. Researcher Bankrate.com estimates variable-rate cards will account for 75% of all cards this year, up from 65% in 2008.

C.D. Reimer of San Jose was switched to a variable card last month. At the same

65%

The percentage of credits cards that had a variable rate in 2008, an amount that could rise to 75% this year.

Data: Bankrate.com

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FOCUS on driving

time the issuer, Barclaycards, upped his rate to 26.99% from around 16%. Reimer could have cancelled the account. But the 40-year-old was laid off from his software support job and depends on plastic. Barclaycards declined to comment.

Fees have been another area of focus. Starting in February, lenders won't be able to charge consumers a penalty when they go over their credit limit. To make up for the lost revenue, issuers are coming up with a host of other penalties. Fifth Third Bank started levying a $19 tariff if a borrower doesn't use the card for 12 months. Notes a FifthThird spokeswoman: "The fee is used to encourage active use of accounts and to offset the increasing costs of accounts."

TARGETING THOSE WHO PAY UP

Citigroup and JPMorgan Chase added annual fees to some products, targeting customers who pay off their balances. "We continue to assess the changes needed to support the extension of credit," says a Citi spokesman. Says a JPMorgan spokeswoman: "We have introduced new products that have fees, but there are defined benefits, and the consumer has the choice."

Overseas purchases may get more expensive as well. Companies regularly charge currency exchange fees, which purportedly cover the lender's cost of converting foreign currencies into dollars. But more have started imposing foreign transaction fees, a charge applied to all purchases made at companies outside the U.S., even if they're made in greenbacks, as is typical with Internet transactions.

Consumer advocates also worry that issuers will dodge marketing guidelines, which clamp down on selling cards to young adults. The rules, part of the second phase, prohibit issuers from giving out freebies to students on or near campus. But the definition of "near" is vague. Some issuers, says Lewis Mandell, a professor at the University of Washington's Foster School of Business, may set up tables a few blocks from the school. Others may hit up parents in the hope of signing up their kids. "Lending to students is profitable," says Mandell. "The companies will just utilize other methods to reach them." |BW|

OBAMA: AFTER THE HALO EFFECT

The President's health-care woes are emboldening lobbyists to go after a bigger swath of his agenda



Some critics say the White House is overreaching on health care

PETE SOUZA/WHITE HOUSE/SIPA PRESS

By Jane Sasseen

In his first few months in office, President Barack Obama benefited from a giant halo effect, thanks to his sky-high approval ratings. That's history now, given the surprising public pushback over the President's quest to overhaul the U.S. health-care system.

Now, some business groups emboldened by the hit to Obama's popularity over health care hope to roll back other parts of the Administration's economic policy agenda. In fact, business lobbyists are putting the final touches on fall strategies aimed at blunting Obama initiatives on taxes, energy policy, and financial reform. Obama's troubles "change the game," says Jade West, head of government affairs for the National Association of Wholesaler-Distributors. "It makes it much easier for those of us fighting for more restrained government and tax policies."

The Administration believes much of the opposition is the result of a misunderstanding over what's truly in Congress' various health-care proposals—and the White House is confident it can overcome that. Still, many voters seem alarmed by soaring deficits and government overreach. "The public feels Obama has spent too much and entrenched the role of big government," says Gregory R. Valliere, chief policy strategist for broker Soleil Securities. Larry Summers, Obama's chief economic adviser, dismisses those concerns and says the White House is optimistic that it will pass a health-

Lobbyists are putting final touches on strategies aimed at blunting initiatives on taxes, energy policy, and financial reform

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care bill. "Success begets success, and that will create momentum."

It had better, for Obama's effort to quickly pass a cap-and-trade bill to limit carbon emissions may be in trouble. Many manufacturers and utilities argue that the costs would weigh too heavily on the still-weak economy—a particularly strong argument in coal-heavy Southern and Midwestern states represented by conservative Democrats. Those lawmakers already face a popular backlash on health care and aren't eager to back another program their constituents don't like. As a result, formal debate on the cap-and-trade has been nudged back until later in the fall.

SHOCKING SCENARIO

Aside from health care, Obama's team also hopes to score wins on financial sector reform. Yet business lobbyists are fighting mightily to derail the White House's proposal for a Consumer Financial Product Agency aimed at boosting protections against predatory lending. Over the August recess, the U.S. Chamber of Commerce held a series of conference calls with local chapters across the country, arguing that the agency's proposed mandate is so broad it would apply to any small business that extends credit to its customers.

In recent days the powerful business lobby has begun running ads claiming that even a local butcher who lets his customers pay at the end of the month could be roped in. "People were shocked" by the ads, says David Hirschmann, president and CEO of the chamber's Center for Capital Markets Competitiveness. Suddenly, he adds, half the heads of local chambers feel targeted. For his part, Summers says such arguments can't be taken seriously.

Even so, these kinds of tactics could prove highly effective politically. Hirschmann says the campaign has generated 17,000 letters to congressional offices. The message may not be quite as scary as "ObamaCare will kill your grandma," but it may be enough to shift the debate. Such are the changing political dynamics confronting the White House. |BW|

CERBERUS NOW HUNTS SMALLER PREY

After a dismal foray into Chrysler, humbled founder Feinberg plans to scavenge among lesser companies



Feinberg admits he made "a bunch of mistakes"

ILLUSTRATION BY JOHN RITTER; PHOTOGRAPH BY HARAZ N. GHANBARI/AP PHOTO

By Emily Thornton

Stephen A. Feinberg is on the defensive. He can deal with barbs about his botched investment in Chrysler and false rumors that some of his hedge funds are about to default. But what pains the reclusive founder of Cerberus Capital Management is the belief that an embarrassing investor stampede from two of his hedge funds has tarnished his reputation for doing what he does best: buy up deadbeat companies and their debt at bargain prices. As Feinberg tells *BusinessWeek*: "If we had just had liquidity at the end of the year and early this year in the hedge funds, I think we could have made back a good amount of money. In our other funds, we did."

Now the 49-year-old titan of distressed investing is fighting back. Despite a rare losing streak, Feinberg says his $24.3 billion firm has raised about $1 billion in recent months. "People still want to invest with us," he insists.

Feinberg also plans to launch several new funds this fall. The goal: get back to his roots. Instead of pouring money into high-profile names such as General Motors' finance arm, GMAC, and Chrysler (a move he now characterizes as a mistake), he plans to scavenge among smaller players. "The bigger, well-known go-go names have been fully priced," Feinberg says. "But there are still a lot of opportunities in the middle market and in structured credit."

Although he maintains Cerberus has coped well with tough times, Feinberg clearly feels humbled by events of the past year. Two core hedge funds, Cerberus Partners and Cerberus International, were down 24% and 21% last year, about in line with the industry average. But this year those funds have stayed mostly flat, while comparable funds are up 15.2%, according to Hedge Fund Research. "We've made a bunch of mistakes, and I wish I could take some of them back," he says.

Feinberg is sanguine, though, about the recent panic at Cerberus. In August, Feinberg imposed new limits on his investors, forcing them to keep their money in his core hedge funds for three years. In response, many tried to yank 60% of the funds' $7.9 billion. "We knew we'd lose some investors," he says. The pool of capital, however, will now be less volatile. "The hedge funds will be smaller. But it was the right thing to do." |BW|

Financial Literacy: Skills For the 21st Century



Harold McGraw III, Chairman, President and CEO of The McGraw-Hill Companies joins winners of the Harold W. McGraw Jr. Prize in Education in ringing the New York Stock Exchange's (NYSE) opening bell.

Consumer credit card debt now exceeds more than $750 billion (The Federal Reserve)
An estimated 28 million Americans are "unbanked"; 44.7 million more are "underbanked" (FDIC's Alliance for Economic Inclusion Website)
The President's Advisory Council on Financial Literacy's 2008 Annual Report identifies financial illiteracy as among the causes for the financial and credit crisis.
Demand for financial literacy help is on the rise; more than a third of The New York Public Library (NYPL) patrons who were surveyed in 2009 said they'd like to see more financial literacy classes and increasingly NYPL branch librarians are being asked for information, advice and materials about financial literacy fundamentals. (NYPL)

Financial Literacy Now: New York

"We have learned many lessons from the current economic crisis. But none is more important than this: financial literacy is critical to our economic well being, and, unfortunately, we are not making the grade.

Every American's ability to provide for our families, achieve financial security and contribute to the growth of the broader economy is dependent on our ability to understand how money works. But according to the Jump$tart Coalition, high school students scored only 48.3% in a recent financial literacy test. And while college students scored better, 62.2%, there still is room for significant improvement. That's why we need to redouble our efforts to educate Americans of all ages about mortgage terms and conditions, as well as such concepts as the impact of compound interest rates on credit card debt, diversification in investing, and the value of saving, just to name a few.



Harold McGraw III, Chairman, President and CEO, The McGraw-Hill Companies

At The McGraw-Hill Companies, our mission is to provide essential information and insight that help individuals, markets and societies perform to their potential. That's why we are excited to partner with several nonprofit organizations on a new campaign, **Financial Literacy Now: New York**, designed to better prepare all New Yorkers to make informed decisions about their finances.

This initiative will focus on three priorities:

- Raising awareness of the importance of financial literacy so we can effect real change in people's knowledge and behaviors.
- Providing greater access to the training, services and information people need to develop these essential skills.
- Enhancing professional development opportunities for teachers so they are equipped to teach financial literacy to students of all ages.

Ours is a local initiative, but clearly this is a national issue. That's why we need public and private support for regional and national programs designed to increase financial literacy for all Americans. This includes supporting educational standards that incorporate basic economics in curricula beginning in the earliest grades. If we put the same emphasis on our children's financial literacy that we do on their ability to read and write, we will go a long way toward helping them realize their dreams, enjoy higher standards of living and achieve a secure financial future for generations to come."

The McGraw·Hill Companies

Bringing Financial Literacy to Those Who Need It Most



The New York Public Library's Bronx Library Center.

At the heart of The New York Public Library's mission to inspire lifelong learning, advance knowledge and strengthen communities is the clear goal of improving the lives of New Yorkers. And, promoting the financial literacy of the most underserved populations in this City is paramount.

In 2009, the Library launched JobSearch@NYPL in response to the loss of hundreds of thousands of jobs in New York City. The impact has been tremendous and one that the Library hopes to replicate with this Financial Literacy Now campaign. For Zvi Blech who visited the Library this spring, the job search resources and staff are vital: "They are very flexible. They work with you." Mr. Blech says that he tells everyone about NYPL's "phenomenal" free classes and services.

As essential as it is to help New Yorkers re-enter the workforce, promoting financial literacy once they're employed is a crucial next step. The Library offers a wealth of financial resources, from electronic databases to printed materials, and an expert staff to guide users seeking to educate themselves in financial matters. The Library conducts more than 100 classes with staff who are extremely knowledgeable about resources relating to finance and investments. Volunteer financial experts deployed throughout the Library's 87 branches will broaden the general public's access to free money management resources and tools.

The New York Public Library is poised to expand this new Financial Literacy Now campaign in libraries across the Bronx, Manhattan and Staten Island. For more information about The New York Public Library please visit www.nypl.org

Empowering the Next Generation Through Economic Education

In the coming years, young people will face unprecedented economic opportunities and challenges. Will they be ready to meet them head on? The answer is yes: provided they understand the "economic way of thinking."



The Council for Economic Education (CEE) is committed to empowerment and opportunity through economic and financial literacy. CEE envisions a world in which young people are prepared to make informed and responsible economic and financial choices throughout their lives. It works to achieve this goal by focusing its efforts on teachers, the key to students' success.

The CEE develops and offers teaching resources and training programs for K-12 teachers in standards-based economic and financial education, so they can teach these vital skills to young people. By giving teachers the tools they need to teach with confidence, millions of K-12 students - nationwide and around the world - will leave school with the knowledge they need to make sound economic and financial decisions later in life.

One recent CEE teacher is Lucia, who took part in a training workshop to help her teach basic financial concepts to her class of at-risk high school students: "I was really impressed with the quality of CEE's program. I can hardly wait to use what I have learned in my own classroom. Most of my students haven't had any exposure to good financial skills. The hands-on activities are just what they need. I want to do a good job and the CEE has made that much easier!" Please visit www.councilforeconed.org

TOP PHOTO: DENIS FINNIN

Financial Literacy Podcasts



Talking Financial Literacy Podcast, or "Talking Fin Lit" as its many listeners have come to know it, gets our nation's educators quickly up to speed on financial literacy, an essential dimension of what kids should learn at school. The show is uniquely equipped to do this through its appealing, entertaining talk show format and its free and user friendly, Internet-based distribution.

Early in the series, teachers in a Texas focus group shared their desires for new financial literacy curriculum, resources, and practices with the show's two producers, Dr. Kathy King and Mark Gura. Both are affiliated with Fordham University's Graduate School of Education and bring a special blend of expertise to the project. As a former head of Math, Science, and Technology professional development for New York City public school teachers, Gura packaged important new ideas for teacher application. King is an internationally recognized expert on professional development and distance learning. Together, they present relevant, feasible approaches to financial literacy instruction with the show's first series of 24 episodes. These explore the current state of financial literacy, presenting important insights, free resources, and suggestions on classroom implementation. The upcoming second series will explore further resources and practices and interview important experts in the field of financial literacy education. The show will provide a public voice to important facets of the Financial Literacy Now campaign, highlighting opportunities for its combined audience. The show is easily accessed at its website, www.talkingfinlit.org .

Understanding Money
and How it Works – for Adults

Literacy Partners, Inc., a not-for-profit organization, provides free community-based adult and family literacy programs that help adults fully realize their potential as individuals, parents and citizens. As the only nationally accredited adult literacy program in New York City, Literacy Partners has taught more than 25,000 adults the basics of reading, writing, mathematics, financial and health literacy through high-quality classes and programs offered at no cost to them or their family members. Through participation in financial literacy programs, previously unbanked adults gain an understanding of money and how it works in today's world. Classroom activities encourage students to actively think through the mathematics and financial skills needed to accomplish larger tasks and translate these skills to daily financial decision making. Financial literacy classes empower students with the necessary information and education to effectively manage their finances and secure fair banking services so that students do not fall prey to risky, deceptive and often fraudulent financial services. Mary S., a Literacy Partners student notes that, "before I started taking classes at Literacy Partners, I cashed my paycheck at a check cashing place. My teacher taught me how to open an account. Now my check is deposited into my own bank account. I also have a savings account and learned how to use the computer to pay my bills."



Effective management of financial resources is crucial to increasing family stability and developing good consumer habits. For more than 35 years Literacy Partners has delivered quality programs throughout New York City. Please visit us at www.literacypartners.org

Financial Literacy Now: New York

Campaign for Financial Literacy

Financial Literacy Now: New York is a project of The McGraw-Hill Companies in partnership with The New York Public Library (NYPL) and several other nonprofit organizations, to raise awareness about the critical importance of financial literacy and provide greater access to training, services and information.

CAMPAIGN HIGHLIGHTS:

- ✓Financial and economic literacy educational materials accessible online and through workshops and seminars
- ✓Easy-access financial literacy resources at select library branch locations
- ✓Financial and economic literacy training for teachers through workshops, podcasts and other online resources
- ✓Financial literacy instruction through adult basic reading classes
- ✓Teacher and student access to business and economic experts bringing real-world economic and personal finance issues to the classroom

www.nypl.org/financialliteracynow

CAMPAIGN LEAD PARTNERS:

- •Council for Economic Education www.councilforeconed.org
- •Literacy Partners, Inc. www.literacypartners.org
- •The McGraw-Hill Companies www.mcgraw-hill.com
- •The New York Public Library www.nypl.org
- •Talking Fin Lit www.talkingfinlit.org
- •Working in Support of Education W!SE www.wise-ny.org

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Prime Minister-elect Hatoyama: Mulling a National Strategy Bureau

TORU YAMANAKA/AFP/GETTY IMAGES

THE OTHER LOSER IN JAPAN'S ELECTION

The Democratic Party of Japan has pledged to severely curtail the powerful Finance Ministry

By Ian Rowley

TOKYO

Time was, mere mention of Japan's Finance Ministry was enough to strike fear into the hearts of policymakers from the White House to Whitehall. The ministry's 15,000 bureaucrats guided Japan's postwar expansion, steering money to everything from social security and defense to rice subsidies and construction. While it has lost some power recently, the ministry still allocates \$2.4 trillion—about 44% of Japan's gross domestic product.

These days, though, much of the fear seems to be coming from inside the ministry itself. The Democratic Party of Japan, which won a landslide election on Aug. 30, has promised to break up the "Iron Triangle" of government, bureaucracy, and Big Business. "We will revive Japan by shifting from bureaucrat-led politics to politics led by the people," DPJ leader—and soon, Prime Minister—Yukio Hatoyama has said.

That doesn't augur well for Finance. One key DPJ idea is a "National Strategy Bureau" where politicians, rather than career bureaucrats, allocate funds. That would represent a huge change from the decades-long practice of ministry staffers drawing up state spending plans with little input from the Diet.

\$2.4 trillion

Spending controlled by Japan's Finance Ministry, equivalent to 44% of GDP*

Data: Finance Ministry
*Fiscal year ending March 2010

Any challenge would be another in a long series of humiliations for the ministry. In recent years, it has ceded its role of market watchdog to the Financial Services Agency and has lost its influence over monetary policy to the Bank of Japan. It even suffered the indignity of having its name changed from *Okura-sho* (a centuries-old term redolent of honor that meant the empire's central treasury) to *Zaimu-sho*, a modern word largely stripped of formality that simply means Ministry of Financial Affairs.

In public, the ministry has put on a brave face. "We must work appropriately if a new government has a new policy," the ministry's top bureaucrat, Vice-Minister Yasutake Tango, told reporters after the election.

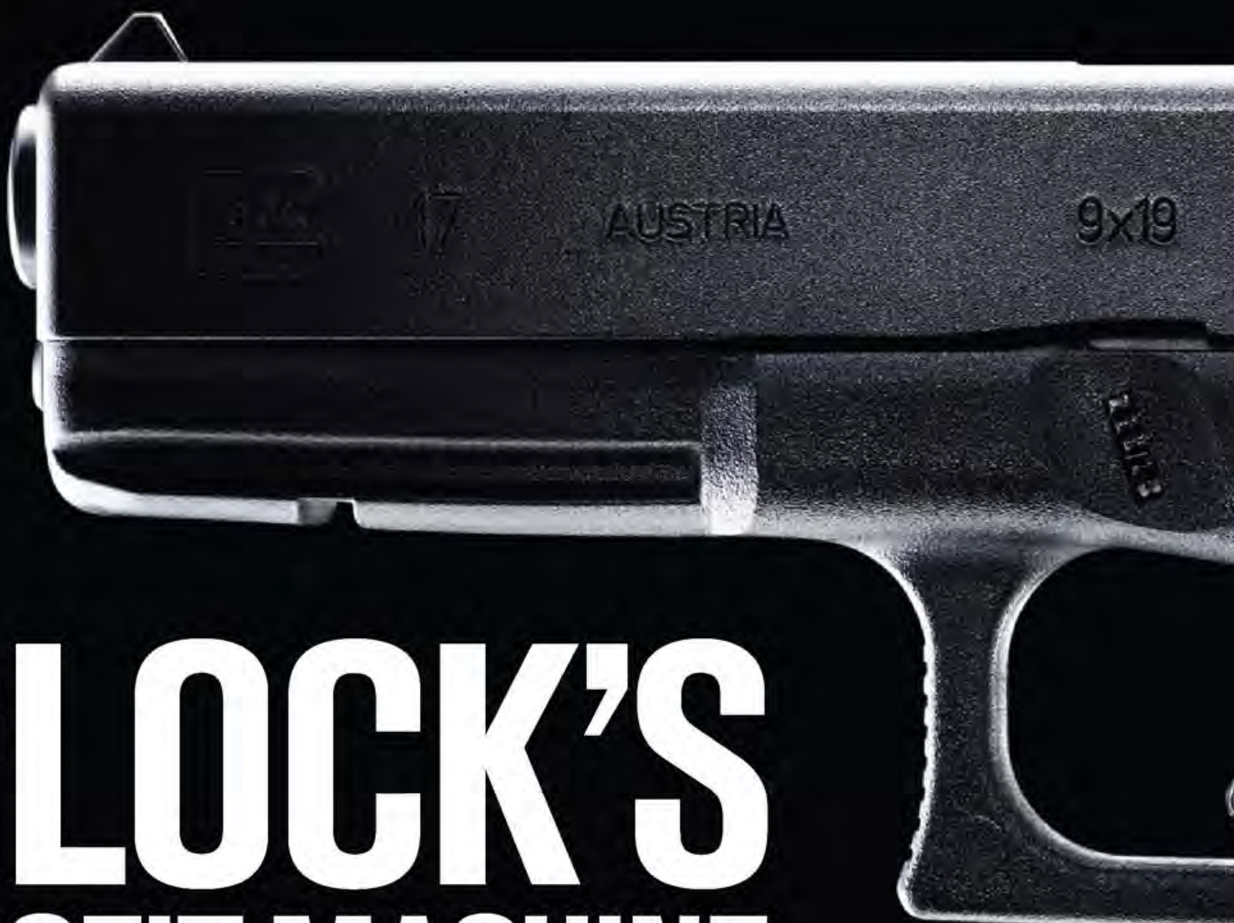
But behind the scenes a big spat is brewing. Ministry officials have called the DPJ's proposed National Strategy Bureau "General Headquarters"—a reference to the U.S. forces that dictated policy after World War II. On the other side, DPJ senior adviser Hirohisa Fujii—a favorite to become the new Finance Minister—told Tango to consider stepping down if he's unhappy with the new government. And Fujii, who spent two decades at the ministry, has vowed to block funding for "wasteful" projects such as a \$5 billion dam and a \$125 million comic book museum (a favorite of outgoing Prime Minister, and *manga* fan, Taro Aso.)

NECESSARY ALLIES

But for all the bickering, the two sides will have to get along. The DPJ's lack of administrative experience could slow efforts to take on the old guard. And the ministry may be the DPJ's best hope of finding the \$100 billion-plus in annual savings it needs to fund costly pledges such as handouts to families with children.

In the near term, the ministry may even strengthen its hand, given its knowledge of budgets at rival ministries that oversee key sectors such as transportation and health. "The DPJ can maintain a hawkish stand in public," says Masaaki Kanno, chief economist at JPMorgan Securities in Tokyo. "But without the help of bureaucrats, nothing can be done." |BW|

–With Hiroko Tashiro in Tokyo



GLOCK'S PROFIT MACHINE

By Paul M. Barrett, Brian Grow, and Jack Ewing
Photograph by Ilan Rubin

Popular with U.S. police, the Austrian handgun has a history steeped in intrigue

Gaston Glock, an Austrian manufacturer of shovels and knives, had an improbable dream: He would make a fortune selling handguns in America. In the early 1980s, Glock, a self-taught firearm designer, produced an innovative pistol for the Austrian military. He then devised a plan for promoting his invention in the U.S., the world's richest gun market. First, he'd persuade American police they needed a lightweight weapon with more ammunition than traditional revolvers. Then he'd use his law enforcement bona fides to win over private gun buyers. ¶ The strategy succeeded spectacularly. By the late 1980s, major police departments across the U.S. wanted more firepower to combat crack-cocaine violence. Glock


GLOCK

had the answer. No less impressed, street gangsters adopted the squared-off Austrian handgun as an emblem of thuggish prestige. Hip-hoppers rapped about Glocks; Hollywood put the pistol in the hands of action heroes.

Gaston Glock shouldered past the storied American brand Smith & Wesson to make his creation the best-known police handgun in the U.S., and probably the world. When American soldiers hauled Saddam Hussein from his underground hide-out in 2003, the deposed Iraqi ruler surfaced with a Glock.

Today the company claims 65% of the American law-enforcement market, an amazing accomplishment for a privately held manufacturer based in tiny Ferlach in southern Austria. U.S. fans celebrate "Glockmas," the 80-year-old founder's July 19 birthday. U.S. sales soared 71% in the first quarter of its 2010 fiscal year, largely due to what gun executives call the "Obama stimulus": fear among gun owners that the liberal President plans to curb the marketing of handguns. Gaston Glock played on that anxiety in an open letter to customers in January. "As shooters and gun owners, we must band together with even greater zeal than in the past," he wrote. "We are not going to roll over and have our guns taken away because of some of our misguided neighbors, no matter who they are."

Behind the Glock phenomenon, however, is another story, one rife with intrigue and allegations of wrongdoing. The company's hidden history raises questions about its taxpayer-financed law-and-order franchise. Is this a company that deserves the patronage of America's police? Does Glock merit the lucrative loyalty of private American gun buyers? The Glock tale also underscores the difficulty U.S. regulators have overseeing complex international businesses.

CLAIMS OF SKIMMING

Allegations of corruption permeate Gaston Glock's empire. His former business associate, Charles Marie Joseph Ewert, now resides in a prison in Luxembourg, having been convicted in 2003 of contracting to have Glock killed. The murder plot—thwarted when the victim, then 70, fought off a hammer-wielding hit man—led to a trial that revealed a network of shell companies linked to Gaston Glock. That corporate web is now under scrutiny by the U.S. Internal Revenue Service, according to lawyers familiar with the probe. Attorneys for Glock have acknowledged the misuse of company funds. But they blame most of the wrongdoing on Ewert, a money man known in the European press as "Panama Charly."

Among the Glock-related material the IRS allegedly is examining: boxes of invoices and memos provided by the company's former senior executive in the U.S., Paul F. Jannuzzo. Once one of the most prominent gun industry executives in America, Jannuzzo said in a federal complaint he filed last year that Gaston Glock used his companies' complicated structure to conceal profits from American tax authorities. "[Glock] has organized an elaborate scheme to both skim money from gross sales and to launder those funds through various foreign entities," Jannuzzo alleged in the sealed May 12, 2008, IRS filing, which *BusinessWeek* has reviewed. "The skim is approximately $20.00 per firearm sold," according to the complaint. Glock's U.S. unit, which generates the bulk of the company's sales, has sold about 5 million pistols since the late 1980s, Jannuzzo estimates in an interview.



A burly man with a staccato delivery, Jannuzzo has several potential motives for airing these allegations. As a whistle-blower, he is seeking a percentage of any federal tax recovery. He is also fighting embezzlement charges by his former employer. Since 2007, the company has been providing information about Jannuzzo to authorities in Cobb County, Ga., where Glock's American subsidiary is based. The Cobb County District Attorney's Office is prosecuting Jannuzzo—who once represented the company at a White House Rose Garden ceremony and on CBS' *60 Minutes*—for siphoning corporate money into a Cayman Islands account. Jannuzzo, who left the company in 2003, claims he's the victim of a vendetta.

Speaking on behalf of the company and Gaston Glock, Carlos Guevara, the general counsel of Glock Inc. in the U.S., said in a written statement: "Glock has acted lawfully and properly throughout its history. Unfortunately, Glock was victimized by several former employees and fiduciaries," including Ewert and Jannuzzo. "The Glock companies are exceptionally well-run and managed. ... Glock's tax filings and reporting are accurate."

A GUNMAKER'S PROGRESS
Major events in the history of Glock

1963 Glock organized in Austria to make metal and plastic products

1970 Manufacturer adds military and police items, such as knives and grenades

1982 Glock receives a contract to make a new service pistol for the Austrian army

1986 U.S. approves Glock for pistol imports; an American unit opens in Smyrna, Ga.

1987 Charles Ewert begins work with Gaston Glock on international corporate structure



Former Georgia Rep. Barr, with handgun, flanked by (l-r) Jannuzzo, Gaston Glock, Robert Glock, and Feldman

Glock's political and public relations activities in the U.S. sometimes have tended toward strangeness. Internal records show payments of thousands of dollars a month over several years to a gun industry lobbyist named Richard Feldman. In interviews, Feldman says that at Gaston Glock's request he spent some of the money in 1999 and 2000 to arrange U.S. appearances by Jörg Haider, then the leader of Austria's anti-immigrant, far-right Freedom Party. Glock has been described in Austria as a political supporter of Haider, although the arms maker has sued both an Austrian newspaper and a politician there for making that claim. The arrangements Feldman says he worked on included Haider's attendance at a January 2000 banquet in New York honoring the birthday of slain civil rights leader Martin Luther King Jr. The King dinner, sponsored by the Congress of Racial Equality, received media coverage because Hillary Clinton criticized her then-rival for a New York Senate seat, Rudolph Giuliani, for attending the celebration Haider present.

Before he died in a car accident last year, Haider stirred controversy, according to media reports, for praising the "character" of elite Nazi SS troops and the "employment policy" of Adolph Hitler. "Glock urged me to help Haider overcome some of the [image] problems," says Feldman. The lobbyist says he thoroughly researched the situation to satisfy himself that neither Glock nor Haider ever supported the Nazi cause. "There were loose statements [by Haider] that were blown out of proportion," he says.

Glock's Guevara did not respond to questions about the company's or Gaston Glock's relationship with Haider.

Still, eyebrow-raising goings-on appear to have been standard at Glock. After the attempt on Gaston Glock's life, an internal investigation conducted at his instruction turned up documents apparently showing that a Glock affiliate in Panama helped in 1995 to start a bank called Unibank Offshore in the Turkish Republic of Northern Cyprus. Unibank's co-founder was an alleged money launderer named Hakki Yaman Namli.

In the U.S., Jannuzzo and another former Glock executive, Peter S. Manown, have claimed that for years they distributed company funds to their wives and Glock employees with the understanding that the money would be donated to congressional candidates—an apparent violation of U.S. election law. The ex-executives, who say they acted with Gaston Glock's approval, have estimated the total amount in the hundreds of thousands of dollars. Buttressing this allegation are ledger entries and cancelled checks. Guevara, the company lawyer, said: "Glock has never authorized, and would never authorize, any act that would violate U.S. campaign finance laws."

GERMAN ARMY CAMPS

Gaston Glock has recounted that he first learned about firearms during a short stint as a teenager in a German military training camp near the end of World War II. "I saw rifle, pistol, hand grenade," he recalled in a deposition taken during a product-liability lawsuit in Knoxville, Tenn., in November 1993. "I was getting acquainted when you pull a trigger, that it makes boom." He said he spent "just a few days in camps of the German Army" in 1944 or 1945, when he was 15 or 16 years old. Asked about his wartime experience in subsequent U.S. court proceedings, he has characterized his contact with the German military as extremely limited.

After the war, Glock, a civilian engineer, held a series of manufacturing jobs and eventually came to run his own company. He learned in 1980 that the Austrian army was in the market for a new sidearm. Despite a lack of experience de-

1987
Jacksonville (Fla.) Sheriff's Office is one of first U.S. agencies to adopt Glocks

1994
Smith & Wesson introduces Glock knock-off; Glock files successful patent suit

1999
Gaston Glock survives attack by hammer-wielding assailant in Luxembourg

2003
Ewert convicted in Luxembourg of hiring hit man to kill Gaston Glock

2008
Paul Jannuzzo, once the company's top U.S. official, indicted for embezzlement

2008-09
IRS allegedly examines the finances of Glock companies

signing guns, he sought the pistol contract. Intense research and consultation with weapon experts prepared him to make a breakthrough. The Austrian Defense Ministry awarded him the contract in 1982, bypassing five other manufacturers.

Simpler than most pistols, the Glock costs relatively little to make. In a 1994 patent lawsuit in the U.S., Glock estimated its profit margin per pistol at 68%. The guns typically sell for \$450 to \$600 in U.S. retail gun stores. The Glock's polymer frame is formed from a mold, not from the more conventional tooled steel. The Glock ammunition magazine, which snaps into the handle, can hold as many as 19 rounds. Revolvers typically hold only six bullets, which are fired from a revolving cylinder.

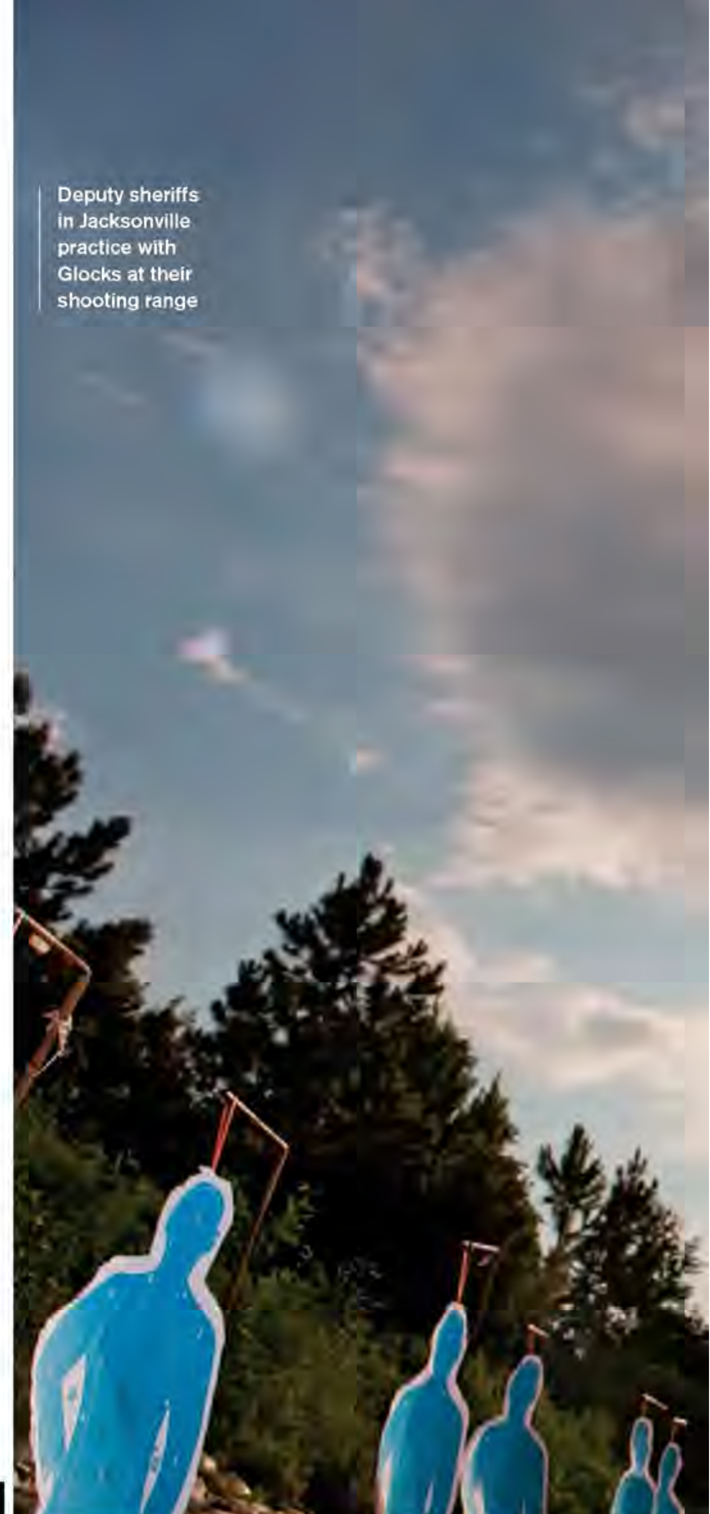
When early Glock models began surfacing in the U.S. in the 1980s, they caused a sensation, recalls Massad Ayoob, a personal defense instructor who runs the Lethal Force Institute in Concord, N.H., and has done promotional writing about Glock. "They looked like something out of *Star Trek*," he says.

DELIGHTING LAW ENFORCEMENT

To sell his gun to U.S. police departments, Glock employed a combination of German-speaking executives and retired American cops. Many police chiefs were receptive to the pitch that they should trade in six-shot revolvers for more potent Glocks. "The bad guys were starting to carry high-capacity weapons, unlike what they had carried in the past," recalls Sheriff John H. Rutherford of Jacksonville, Fla. As a lieutenant, he led a study in 1987 that resulted in the department buying Glocks. The 1,700-member force still uses the brand.

"It was a conscious decision to go after the law enforcement market first," Gaston Glock told *Advertising Age* in June 1995, when the trade magazine honored him as one of its "Marketing 100" stars. "We assumed that, by pursuing the law enforcement market, we would then receive the benefit of 'after sales' in the commercial market." Police departments from New York to Miami to St. Paul, Minn., signed on. The strategy closely resembles that of firearm pioneer Samuel Colt, who popularized his six-shooter in the mid-19th century by seeking endorsements from soldiers and lawmen.

Syndicated columnist Jack Anderson raised the Glock profile when he wrote in January 1986 that Libya, a notorious terrorist threat, was trying to acquire Austrian-made "plastic" guns that could evade metal detectors. Glock pistols are actually made mostly of metal and are easily identified by alert airport screeners. The company denied it was marketing to Libya. Rather than tarnish the gunmaker, the Anderson column helped spread the idea that serious bad guys preferred Glocks, says Robert Ricker, a longtime lobbyist for the firearm industry. "It was an incredible lucky break," Ricker adds. "It raised public awareness, got people interested in it." Sales grew rapidly.



Deputy sheriffs in Jacksonville practice with Glocks at their shooting range

At nearly every turn, Gaston Glock and his executives displayed impressive marketing and legal savvy. When arch-rival Smith & Wesson in 1994 came out with a Glock-like pistol called the Sigma, Jannuzzo led a successful patent-infringement lawsuit. S&W agreed to pay an undisclosed settlement and modify its gun. An S&W spokesman declined to comment on the confidential resolution, other than to say the company had neither admitted nor denied wrongdoing. Glock now offers about 40 models in various calibers. "They're simple, they work, and you don't have to mess with them," says

THE GLOCK STRATEGY RESEMBLES THAT OF FIREARM PIONEER SAMUEL COLT, WHO GOT LAWMEN AND SOLDIERS TO ENDORSE HIS SIX-SHOOTER



JEFFERY SALTER/REDUX

Herman Gunter III, an investment adviser in Live Oak, Fla. He owns two Glocks for personal defense and target shooting.

The company has boosted its profits with innovative pricing strategies. It has offered discounts to police on new pistols if cities turn over used service weapons and guns confiscated from criminals. Glock has arranged to have the second-hand firearms sold on the used-gun market, where former police weapons command a premium.

With Jannuzzo as its U.S. front man, Glock deftly ducked repeated legal assaults on the gun industry. Jannuzzo, a former state prosecutor in New Jersey who joined the company in 1991, displayed a knack for talking compromise while rarely giving much ground. In one notable episode in 2000, he made encouraging noises about a master settlement with the Clinton Administration and more than 20 cities that would have shielded gunmakers from future liability in exchange for restrictions on gun marketing. But at the last minute, Jannuzzo pulled back from the deal, leaving rival Smith & Wesson as the only industry signatory. A boycott led by the National Rifle Assn. temporarily crippled S&W, while Glock and other manufacturers enjoyed a sales surge. The settlement later collapsed, and the issue faded when Congress passed a statute in 2005 to protect gunmakers in court.

Even as the Glock company faced courtroom challenges in the U.S., a more personal and dangerous conflict was playing out for Gaston Glock in Europe. Beginning in 1987, the Aus-

trian industrialist had employed Charles Ewert as his financial architect. "I was not a salesman. I am a technician ... so I had to find a partner that helps me to sell the pistol," Glock explained in a U.S. court deposition in September 1995.

Ewert, a mustachioed Luxembourg resident now in his late 50s, wasn't exactly a salesman either. Nicknamed "the Duke" by Glock employees because of his imperious manner, he was a purveyor of shell companies: paper corporations that can be used to shield income from taxation—sometimes legitimately and sometimes in questionable ways. Ewert designed a network of shells to lessen the gun empire's exposure to product liability and potential taxation, according to documents filed with the Luxembourg court. These firms absorbed millions of dollars, the records show.

VIOLENT ATTACK

Over time, Ewert transferred ownership of some of the Glock-affiliated shells to himself, according to Luxembourg court judgments. Suspicious of Ewert, Gaston Glock sought an explanation in July 1999. On the afternoon of a meeting scheduled at Ewert's office near the tony Rue Royale in central Luxembourg, Glock was attacked in an underground garage. The hit man, a former professional wrestler and French Legionnaire named Jacques Pecheur, bashed the businessman on the head with a rubber mallet, a technique apparently aimed at making it look like the victim had fallen down and fatally injured himself. Glock, physically fit from daily swimming—often in the frigid lake abutting his home near Klagenfurt, Austria—fought back. When police arrived, they found Glock bleeding from gashes to his skull. Pecheur, 67, was unconscious.

Luxembourg investigators found Ewert's business card in Pecheur's car and determined that the two had met at a gun range in Paris in 1998. Both were convicted of participating in a conspiracy to kill Glock. Pecheur received a sentence of 17 years, Ewert 20.

Ewert denies any involvement in the attack, which he blames on unnamed Glock associates who he alleges wanted to gain control of the manufacturer. "They needed me out of the way so they could grab everything," he says in an interview at a maximum-security prison in rural Luxembourg. His lawyers are appealing his conviction to the European Court of Human Rights in Strasbourg, France, arguing that police improperly seized records from Ewert's office that were protected by attorney-client privilege. Pecheur was released early from prison in 2007 for good behavior, his attorney, Fränk Rollinger, says. Pecheur couldn't be located for comment.

Although Gaston Glock saw his antagonists punished and regained control of his corporate holdings, the investigation of the attempted killing and related financial fraud opened a window on the gun company's finances. Most striking are their sheer complexity. With Ewert's help, Gaston Glock purchased a Panamanian shell company called Reofin International in 1987. Reofin then bought Unipatent Holding, a Luxembourg shell. Unipatent received a 50% stake in Glock's unit in the U.S., where the company generated the vast majority of its revenue. "The purpose of this holding company [Unipatent] was to appear externally as a partner of Glock and hold approximately 50% of the shares of its subsidiaries," according to an Apr. 3, 2000, document entitled "Establishment of the Glock Group," which Gaston Glock's attorneys filed with the Luxembourg court.

Three other shell companies in Ireland, Liberia, and Curaçao were created to issue bills for various "services" to Glock headquarters in Austria and operating units in Latin America and Hong Kong. But these service firms "had no economic substance and were motivated by tax reasons," according to a confidential 92-page analysis of the Glock companies in 2002 by auditing firm PricewaterhouseCoopers. PwC had been retained by the provisional administrator of Unipatent appointed by the Luxembourg court. The PwC auditors



AFTER A 1999 ATTACK, GLOCK WAS FOUND BASHED AND BLEEDING. THE HITMAN HIRED BY A BUSINESS ASSOCIATE WAS UNCONSCIOUS



At a New York event: from far left, Ricker and Jannuzzo; on the far right, Haider; (inset) Gaston Glock with Haider

found that the service companies' role appeared to be the shielding of profits from potential taxation in Austria, Latin America, and Hong Kong.

The Latin American and Hong Kong units, in turn, appeared to be used to extract profits from the U.S. subsidiary, PwC alleged—an assertion reiterated by the 2008 IRS complaint filed by Jannuzzo. American tax liability allegedly was artificially lowered by having pistols manufactured in Austria sold first to the Latin American and Hong Kong units and then resold for higher prices to Glock Inc. in the U.S. By inflating costs to the American subsidiary, this arrangement decreased the profits the subsidiary reported to the IRS, according to Jannuzzo.

A spokeswoman for the IRS, Patricia Bergstrom, declined to confirm or deny that the agency is investigating Gaston Glock or his companies. The IRS, says Jannuzzo, has interviewed him about Glock three times since June 2008.

Glock's Guevara said that the company has undergone "a series of comprehensive governmental audits going back to 1988" in the U.S. and Austria. "No audit has ever resulted in findings of tax fraud in any jurisdiction," he added.

For nearly three years after the attempt on his life, Gaston Glock employed a team of investigators to probe the workings of his own company. This group, referred to in internal correspondence as "the A-Team," was headed by James R. Harper III, an ex-U.S. Justice Dept. prosecutor. Harper discovered that Reofin, the Glock affiliate in Panama, had taken part in starting Unibank Offshore in Northern Cyprus in 1995. Unibank's co-founder, according to documents *BusinessWeek* has reviewed, was Hakki Yaman Namli. Law enforcement officials in the U.S. and Europe have alleged that Namli, who is of Turkish descent, launders funds for crime syndicates. In 2003, a federal grand jury in Manhattan indicted him for fraud carried out through another outfit in Northern Cyprus, First Merchant Bank, which Namli controlled. A year later, the U.S. Treasury designated First Merchant as a "primary money-laundering concern." Turkey closed the bank in 2006. Namli is listed as a fugitive in the New York case.

Harper told Gaston Glock and Jannuzzo he believed that Ewert was the one who involved the Glock companies with Namli. But Harper wrote in a memo to Jannuzzo dated Nov. 1, 2000, that Gaston Glock "is in danger of being flagged as an international money launderer because by all appearances ... Ewert was working at [Gaston] Glock's direction up until the time of the assault [on Glock]." Harper added: "Mr. Glock doesn't understand the breadth of the problems or the potential disaster that could befall him."

Glock's Guevara said that neither the company nor Gaston Glock has ever had any relationship with "a banking institution in Turkey or [the] Turkish Republic [of] Northern Cyprus."

In recent years, the gun company's U.S. operation has been rattled by scandal. Local authorities in Georgia have prosecuted Jannuzzo and fellow former executive Peter Manown at the behest of their former employer. On Oct. 18, 2007, Manown, an attorney who handled many of Gaston Glock's personal matters in the U.S., testified that he and Jannuzzo had embezzled company funds and funneled the money to accounts in the Cayman Islands. He said the pair also skimmed money from Glock real estate transactions. And Manown said he and Jannuzzo had withdrawn more than $500,000 from Glock accounts for political campaign contributions from 1993 to at least 2003. The executives put some of that cash in their own pockets, he testified. "There was so much money flying around in this company," Manown said. "It was like Monopoly money." He recounted confessing his transgressions privately to Gaston Glock back in 2003 and repaying some of the stolen money. The former Glock executive pled guilty in 2008 to theft and received a suspended 10-year sentence.

In connection with the campaign contributions, Manown testified that Gaston Glock knew what his underlings were doing: "This was all done ... with Mr. Glock's blessing." Manown said he and Jannuzzo would withdraw cash for po-

(INSET) GERT EGGENBERGER

litical contributions from a Glock account at the since-closed Summit Bank in Atlanta. Sometimes the Glock executives withdrew "$9,000 so it would stay under the reporting radar of the bank," Manown said. He was referring to the federal anti-money laundering rule that requires banks to report to the Treasury Dept. any cash withdrawal of $10,000 or more. Purposely evading the requirement is a federal crime punishable by up to five years in prison.

AMONG THE GLOCK-AFFILIATED CAMPAIGN GIFTS WERE CONTRIBUTIONS TO SENATOR SAXBY CHAMBLISS. HE PLANS TO RETURN THE MONEY

Manown went on to explain that he and Jannuzzo at times wrote checks on the Glock account to themselves and to their wives. Jannuzzo later "spread [some of the money] around [to] other people at Glock," with the understanding that they would use the funds to make political contributions, Manown added. He kept a handwritten ledger of many of the withdrawals. A Nov. 1, 2000, entry shows $60,000 designated for "Bush election campaign per GG and PJ 4 RF." GG apparently is Gaston Glock; PJ, Paul Jannuzzo; and RF, Richard Feldman, the lobbyist and consultant. The Cobb County District Attorney's Office declined to comment on any "matters related to open cases."

ALLEGATIONS OF THEFT

A review of federal campaign donations by Glock employees between 1991 and 2004, conducted for *BusinessWeek* by the nonprofit Center for Responsive Politics, shows more than 100 individual donations worth a total of at least $80,000. Jannuzzo says many more contributions were made by Glock employees and associates for less than $200 apiece to avoid election-law reporting requirements. Among the recipients of Glock-affiliated campaign contributions were former Atlanta-area Republican congressman Bob Barr, and two current Republican members of Congress from Georgia, Representative Phil Gingrey and Senator Saxby Chambliss.

Barr said in a written statement that all donations he received from people affiliated with Glock were "fully and appropriately reported to the [Federal Election Commission], and so far as we knew, were legitimate." A spokeswoman for Gingrey said in a separate statement: "We have never knowingly received any unlawful contributions." A Chambliss spokeswoman said that to be on the safe side, the senator planned to return contributions from Glock-affiliated donors.

Glock had a number of reasons to try to make an impression on Capitol Hill. Gun control proposals that could affect its business were being debated. The gun industry also lobbied for federal protection from liability lawsuits, culminating in the enactment of such a law in 2005.

In his written response, Glock's Guevara said: "Manown and Jannuzzo stole over $500,000 of Glock money for themselves and then labeled it political contributions to hide their crimes. In any event, we conducted our own due diligence, which revealed that Manown's ... statement that Glock money was spread to employees to make political contributions is entirely false (except as to Manown and Jannuzzo). ... With respect to the allegation that Glock contributed $60,000 to the 2000 Presidential political campaign, the evidence shows that Manown stole this money from Glock and transferred it to Cayman Island accounts controlled by Manown and Jannuzzo."

Manown's confession in Cobb County had serious consequences for Jannuzzo. On Jan. 14, 2008, the onetime U.S. chief of Glock's U.S. operation was arrested and charged by local authorities with theft and racketeering. The indictment alleges Jannuzzo stole a semi-automatic pistol from his former place of employment and conspired with Manown to embezzle $177,000 from Gaston Glock. Jannuzzo denies the charges. He says he never stole any money. The dealings described in the indictment related to his effort to help his former colleague Manown resolve his mismanagement of Glock funds, Jannuzzo says. As for the disputed handgun, Jannuzzo maintains he volunteered to return it but no one at Glock ever took him up on the offer.

In contrast to these denials, Jannuzzo admits he reimbursed fellow Glock employees and others for making political contributions, which was illegal. He says he first discussed the practice with Gaston Glock in 1993 during a meeting in Austria. The reimbursements, Jannuzzo adds, continued for at least 10 years. Glock indicated strong interest in the donations. "He would say, 'How are we doing? What do the candidates look like? Do we need to make some contributions?'" Jannuzzo adds: "[Gaston Glock] knew 100%. I talked to him personally about it on the phone."

No one has been charged in connection with the alleged reimbursements. Some may now be beyond prosecution because the statute of limitations has expired. |BW|

BUSINESSWEEK.COM | To see a video of the Glock pistol in action, go to http://www.businessweek.com/go/09/glock. You can also read more about alleged gun-safety issues and Gaston Glock's accounts of the company's ownership.

Business Exchange

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Hoarding Rounds

The "Obama stimulus" that caused a surge in gun sales has created another bull market—for bullets. The *Los Angeles Times* reported on Aug. 30 that ammunition prices have jumped as gun enthusiasts, worried about new restrictions, stock up on firearms and ammo. "Bullet factories are running around the clock to meet demand," the *Times* noted. The Obama Administration has not, however, made a move to toughen gun control, let alone ammunition control.

To read this article, go to **http://bx.businessweek.com/us-manufacturing/reference**

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CAN THE FUTURE BE BUILT IN AMERICA?

By Pete Engardio
Photograph by Eric Millette

The U.S. is losing its lead in large-scale high-tech manufacturing. But smarter tax policies, low-cost loans, and special industrial zones might help keep factories at home

From its headquarters in a modest office park outside Sunnyvale, Calif., Bridgelux is hoping to spark a revolution in light fixtures for homes and offices across the U.S. It's ready to ramp up production of tiny light-emitting chips that blaze as bright as some incandescent bulbs but consume a fraction of the energy. To meet surging orders for its chips, it's prepared to spend $250 million over three years on gleaming cleanrooms. The question is, where should it put its plants?

For a host of strategic reasons, Bridgelux would like to keep manufacturing in the U.S., but financial realities point to Asia. Not only are taxes far lower and government incentives more generous in such nations as Malaysia, China, and Singapore, but it's easier to raise cheap funding offshore than in the U.S., where private investors frown on manufacturing and bank lending is nearly frozen. CEO Mark Swoboda calls the decision "the toughest challenge facing our company."

Not that long ago it didn't seem to matter where such companies made their stuff. After all, America has been inventing industries and losing them to Asia for decades, from color TVs to memory chips, personal computers, and liquid-crystal displays. While the Japanese, Koreans, Taiwanese, and Chinese plowed billions into megaplants to churn out commodity products, America steamed ahead in more lucrative pursuits, such as software, life sciences, and financial services. As for companies such as Dell and Apple, they could still reap high profits by focusing on marketing and design while letting offshore contractors handle the grunge work.

That situation has changed in dramatic ways. At a time when the U.S. is desperate for new sources of growth, Bridgelux and hundreds of other startups that represent the best hope for a manufacturing renaissance find it almost impossible to achieve scale in the U.S. It's troublesome because these com-



Bridgelux's Swoboda would like to manufacture in the U.S.

panies are launching a blizzard of innovative products that promise to disrupt entire industries, including tiny diodes that could reshape the $100 billion global lighting business, fuel cells to power electric cars, and thin, flexible TV screens and solar panels. "When large transformations like this occur, everything gets reset with new winners and losers," says CEO Alan E. Salzman of San Bruno (Calif.) venture capital firm VantagePoint Venture Partners, which has stakes in Bridgelux and 21 other clean-energy startups. "If you aren't in the game from the beginning, you don't get a second chance."

The good news is that the U.S. is at or near the cutting edge in most of the emerging product areas. Indeed, the new wave of high-tech devices hitting the market is the payoff from billions of dollars in taxpayer-funded research at federal and university science labs stretching back to the 1960s, when the applications were but glimmers in the eyes of futurists.

Now the bad news: Unless the U.S. can magically resurrect its manufacturing base, the good-paying jobs from these breakthroughs will be offshore. Cheap Asian labor has little to do with it. Unlike other industries that fled to low-cost offshore havens, these emerging tech goods are made on highly automated production lines. The problem is, the U.S. is losing its lead in large-scale high-tech manufacturing.

You can see this in the balance of trade. In 2000 the U.S. exported $29 billion more high-tech products than it imported, notes Harvard Business School professor Willy C. Shih. Owing to a legacy of underinvestment in manufacturing, by 2007 that had turned into a $54 billion trade deficit.

The causes of this manufacturing decline "are numerous, complex, and a long time in the making," says Shih, a 14-year IBM veteran and former president of Eastman Kodak's digital consumer products unit. Two decades of unconstrained outsourcing to Asia have hollowed out much of America's base of suppliers, factory managers, and skilled technicians. U.S. private capital markets, meanwhile, are loath to tie up their billions in factories and machinery. In the boom years from 1994 to 1999, when the economy surged 26%, U.S. manufacturing capacity swelled by 44%, according to a *BusinessWeek* analysis of Federal Reserve Bank data. From 2002 through 2007, when the U.S. expanded by 17%, capacity rose a paltry 5%. Over that time, Chinese investment exploded.

HIGH CORPORATE TAXES

Much of the blame lies with U.S. government policy. Nations in Asia and Europe aggressively court strategic high-tech industries with generous tax breaks, cash grants, cheap credit, low-cost utilities, and speedy regulatory approval. Governments prize such plants because they serve as broad economic catalysts. Besides skilled jobs, they spur parts suppliers, construction work, services, and the creation of big engineering forces that are the pillars of new industries and companies.



RICHARD MORGENSTEIN

By comparison, the U.S. has been indifferent to manufacturing. Even when tax breaks are factored in, American corporate taxes are among the highest in the industrialized world, according to a World Bank study. Nor does the U.S. simply exempt certain industrial investments from taxes, as does much of Asia. Most U.S. states do offer tax breaks and financial aid to lure big plants, hoping to recoup the cost with income taxes generated by new jobs. But state taxes pale beside federal levies, and state budgets for subsidies are limited. "The states are playing with peanuts, while other countries play with real money," says Clyde V. Prestowitz Jr., president of the Economic Strategy Institute, a Washington think tank. Also, it can take two years to obtain all the environmental, health, and safety permits for a modern electronics plant—a lifetime in the tech world. "The political guys in Washington don't have their minds around the fact that the climate for manufacturing here is really hostile," says Joseph R. Laia Jr., CEO of Santa Clara (Calif.) solar cell startup MiaSolé, which is trying to decide whether to build its first major plant in the U.S., Europe, or Asia.

"OTHER COUNTRIES ACTUALLY PAY YOU TO CREATE JOBS. THE REST OF THE WORLD IS CHEWING US UP ALIVE" BILL WATKINS, FORMER CEO OF SEAGATE TECHNOLOGY

Bill Watkins, former CEO of disk-drive maker Seagate Technology, compares America's predicament with an old corpo-



MiaSolé's Laia: "The climate for manufacturing here is really hostile"

ration that can't adjust to a new business model. In his years at Conner Peripherals and then Seagate, Watkins set up plants in such countries as Ireland, Malaysia, and China. Last year he moved Seagate's 1,500-worker plant in Milpitas, Calif., which made various storage devices for video and photos, to Singapore. "Other countries actually pay you to create jobs," says Watkins. "The rest of the world is chewing us up alive."

The U.S. can still stem this decline with smart and bold policies. Washington has launched a number of industrial initiatives. The U.S. gives homeowners tax credits to cover 30% of the cost of installing solar panels, for example, and has set aside $25 billion in loan guarantees to help automakers build fuel-efficient vehicles. Obama's team is doling out billions in tax credits and loans to help companies build factories to make solar cells and lithium-ion car batteries. Washington is boosting spending on research and development centers for advanced manufacturing technologies, incubators for small businesses, and workforce training. And Obama has appointed Ron Bloom, head of the government's auto task force, to the new post of manufacturing policy czar. "We recognize manufacturing is and will be a critical part of the national economy and have a very robust approach to supporting it," says National Economic Council Deputy Director Diana Farrell.

But policies unveiled so far are stopgap measures justified by the financial crisis. And handing out aid on a case-by-case basis raises suspicions of political favoritism and puts public servants in the risky role of picking winners. Federal investment tax credits, meanwhile, aren't enough to offset the financial incentives offered by Asia and Europe. "They are a helpful step, but what's really needed is a systemic overhaul of the corporate tax code to spur capital investment," says Robert D. Atkinson, president of Information Technology & Innovation Foundation (ITIF), a Washington think tank.

Now many U.S. executives are calling for the kind of comprehensive game plans for nurturing industries found in Europe and Asia. Some 60% of North American manufacturing execs surveyed by Deloitte Research and the Manufacturing Institute said they believe U.S. competitiveness will decline further by 2012, and 77% said the U.S. needs a strategic approach to developing a manufacturing base.

At a National Business Summit panel in Detroit in mid-June, Dow Chemical CEO Andrew N. Liveris and Ford Motor Executive Chairman William Clay Ford Jr. both openly called for "industrial policy," a term not heard much since the U.S. was under siege from Japanese cars, chips, and steel in the early 1980s. General Electric CEO Jeffrey R. Immelt declared that GE had probably gone too far in outsourcing manufacturing, engineering, and back-office service work and lambasted as "flat wrong" the notion that the U.S. could remain an economic superpower by relying on services and consumer buying.

The Obama Administration is certainly wading into industrial policy with its bailout of Detroit and aid for green-tech factories. Still, there is little talk about Washington mapping long-term strategies for industries. To do so would go against the philosophy that has guided U.S. policymakers for much of the postwar era, which is to focus federal spending on R&D while letting the market figure out how to commercialize technology. Rewriting corporate tax codes to favor manufacturing, meanwhile, would run into big political obstacles. Liberals tend to view tax cuts as corporate welfare, while many conservatives argue tax cuts should apply to all corporations and not favor specific sectors. Either way, says Deborah L. Wince-Smith, president of Washington's Council on Competitiveness, the U.S. suffers from "a total divorce between our tremendous investments in R&D and manufacturing."

Few industries better illustrate the disconnect than solar cells. Since the 1970s federally funded labs have produced many of the breakthroughs in cells that turn the sun's rays into electricity. Yet Japan commercialized panels for homes and businesses. Now China dominates the $30 billion global solar industry, making 35% of the world's cells and 49% of its polysilicon wafers, the main material used for solar cells. The U.S. makes just 5% of cells. A growing portion of solar equip-

ment bought with U.S. tax credits is imported from China, where a capacity glut has sent prices crashing.

It's not too late for the U.S. to jump back into the game. Even though global demand for solar systems in homes is slow now, it is expected to triple in four years. Moreover, the technology is shifting to an American bastion of strength: cells made from thin coatings of elements on flexible materials, such as foil and polymers, that are far cheaper and easier to make than silicon wafers. "There is plenty of opportunity for the U.S. to take the lead here," says Michael J. Ahearn, CEO of First Solar, in Tempe, Ariz., the world's thin-film leader.

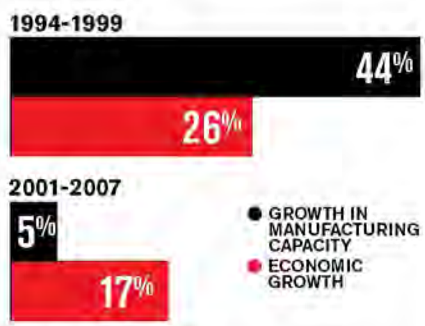
Still, most of the capacity of the U.S.-based companies is offshore. First Solar invested $1 billion to double capacity this year, creating 4,000 jobs, and it aims to open a new plant every three months. But 86% of its output is in Germany and Malaysia, and a major plant is coming in France.

A big reason is that European and Asian nations have done more to stimulate domestic demand with something called feed-in tariffs. These require utilities to buy solar-generated electricity at rates far higher than they pay for power from fossil fuels, thus guaranteeing reliable profits for solar plant developers and operators. Only a few U.S. states require utilities to pay extra for solar power, and the scale of U.S. solar farms is much smaller. "The current demand will not create an industry in the U.S.," says Subhendu Gahu, CEO of United Solar Ovonic, a Rochester Hills (Mich.) manufacturer.

Even if U.S. tax credits greatly boost demand for solar panels, Deutsche Bank analyst Stephen O'Rourke reckons the U.S. will account for less than 15% of solar cells sold globally by 2011, compared with 60% or more for Asia. Although it varies by company, a plant in Asia can be as much as 30% more profitable to operate over many years, even factoring in shipping costs, than one in the U.S. The main reason: attractive tax structures and subsidies. Absent other incentives, "you would need a negative tax rate" to level the playing field, he says.

AMERICA'S WANING INDUSTRIAL BASE

In periods of economic growth, U.S. companies boost manufacturing capacity. But that didn't happen the last time around.



Data: Federal Reserve Bank
Analysis by *BusinessWeek's* James C. Cooper

These are real considerations for a startup such as MiaSolé. Like many U.S. solar makers, MiaSolé's technology was aided by years of research at the U.S. National Renewable Energy Laboratory in Golden, Colo. In July the company began shipping key solar components from its small Santa Clara headquarters. MiaSolé's advantage, says CEO Laia, is proprietary production processes. Its $190 million prototype plant looks like a jumble of vacuum chambers, pumps, generators, and cooling pipes. But in half an hour, the plant can take 2.5 miles of rolled steel half the thickness of a human hair and apply superthin coatings of copper, indium, gallium, and selenium. Out come cells that, MiaSolé claims, can generate electricity twice as efficiently as other thin-film cells on the market.

It won't be long before Asian rivals appear, so MiaSolé wants to ramp up now. By mid-September it aims to decide where to build a plant for high-volume production. Laia, a scientist at New Mexico's Los Alamos National Laboratory for 11 years who ran two chip equipment makers, prefers the U.S., but "10-year tax holidays in Asia are really hard for a board to get around," he says.

Solid-state lighting also illustrates America's "invented here, industrialized elsewhere" syndrome. U.S. labs have been among the leaders in light-emitting diodes, the superefficient devices on track to replace incandescent and fluorescent bulbs. Bridgelux is among the few U.S. producers of commercial LED units. It makes a chip the size of a dime packed with LEDs yielding bright white light that can be used in homes and offices. Current LED-powered devices are pricey: The equivalent of a 40-watt bulb costs $70 and up. Within two years, Bridgelux thinks it will be able to make the equivalent of a 60-watt bulb now used in most homes for less than $10.

But Bridgelux is up against a big initiative in China. The city of Dalian alone is fostering more than 40 LED companies and is helping ensure a big local market by converting 200,000 street lamps to LED.

In the U.S., Bridgelux's sales are on pace to double this year, to $24 million, and the global LED market is expected to reach $12 billion in three years. "The challenge we face now is trying to get a factory in place in time to service this exploding market," says CEO Swoboda. The company wants to start with a small U.S. plant and has been scouring California for old chip facilities it could convert—but the cleanrooms are in such a state of disrepair that even this goal may not be reachable without heavy investment. "We were shocked that we found nothing," Swoboda says. "All of the cleanroom space was torn out and property owners converted these fabs to offices."

The harder task is figuring out where to build the large-scale facilities. To be near Bridgelux's scientists and protect intellectual property, Swoboda wants to stay in the U.S., but investors are balking at the high costs. The company is now applying for an Energy Dept. loan, but it's also getting great offers from Singapore, China, and Malaysia. Examples like this worry Robert Street, a senior research fellow at Palo Alto Research Center (PARC) who specializes in a related field known as flexible electronics (box). "We could just be a big funnel of R&D to Asia," he says.

One area where the U.S. is backing up R&D with manufacturing aid is rechargeable lithium-ion batteries for cars. With the auto world moving toward electric vehicles, having domestic battery producers is seen as vital to retaining a U.S.-based car industry. In August the Energy Dept. lent $2.4 billion to A123 Systems, EnerDel, Johnson Controls, and other companies to build factories in the Midwest.

Yet already, General Motors has awarded its contract to supply batteries for the Volt, due on the roads in 2010, to South

Korea's LG Chemical, which will assemble battery packs in Detroit from cells made in its home country. U.S. upstarts also will compete with better-funded Asian giants such as Panasonic and China's BYD Auto, which dominate mass production of lithium-ion batteries for consumer electronics. The biggest markets, moreover, are likely to be in Asia, where carmakers are ahead in developing electric vehicles and governments keep gasoline prices high. "This industry will not be inside the U.S.," predicts VantagePoint's Salzman.

What can Washington do to boost manufacturing competitiveness? It could bridge the disconnect between R&D and commercialization, as it has done in biotech. If the U.S. believes flexible displays, fuel cells, or solid-state lighting warrant billions in R&D, it should follow through with enough aid for product development and manufacturing.

To critics of government intervention, such measures smack of picking winners, but it's not as if that's something new to Washington. Agriculture and oil drilling remain heavily subsidized. The federal government was crucial to launching the aerospace, telecom, and Internet industries. Now it owns General Motors. "We do have an industrial policy," says Craig A. Giffi, vice-chairman of Deloitte Consulting. "What we don't have is a coherent industrial policy. We don't know what industries we want and where we are going."

Even short of an overarching strategy, there is a lot the U.S. can consider. Perhaps it's politically impossible to grant corporations 10-year tax holidays for building a factory, says ITII's Atkinson. But Washington could allow companies investing $100 million, say, in a new high-tech plant to write the entire sum off in the first year, rather than depreciate it over time. To create enough demand for large-scale domestic production of renewable energy equipment, the U.S. could impose European-style feed-in tariffs on all utilities.

And rather than dispense limited funds to a chosen few, Washington could offer low-cost loans for all new U.S. factories that can show they have a market and meet certain criteria. Or it could create an institution similar to the U.S. Export-Import Bank, which lends to companies so they can fill export orders.

The U.S. could even explore strategies used in certain emerging markets. Hau L. Lee, a professor at Stanford Graduate School of Business, thinks America needs large industrial zones devoted to specific industries—similar to zones in Taiwan, Singapore, Malaysia, and much of China. Such areas offer tax breaks, cheap or free land, workforce training, plenty of water and power, and agencies that serve as one-stop shops for all of the necessary permits and regulatory approvals. The idea isn't too far-fetched. The Interior Dept. hopes to set aside thousands of acres of federal land in the West for 13 solar power generation zones, with a special office in Nevada to approve projects quickly. Such zones also could include solar manufacturing plants.

Thinking like a developing nation may be a comedown for the world's greatest economic superpower. But that is the level to which America's manufacturing might has eroded. Unless it changes course, the U.S. not only won't be able to recapture industries it has lost—it may not be able to launch the new industries it invents. |BW|

ILLUSTRATION BY DAVID POHL

LOSING OUT ON FLEXIBLE DISPLAYS

The U.S. has likely missed this boat

Some high-tech industries based on taxpayer-funded research are gone even before U.S. companies put up their first plants. The latest example: low-power organic LEDs, or OLEDs.

For decades, U.S. labs have been working on ways to fabricate such devices on ultrathin sheets of plastic. U.S. startups have envisioned uses such as flexible diagnostic devices attached to the skin and head-mounted displays for soldiers. The big bucks, however, will likely be in large displays for TVs or computers—and most will come from Asian electronics companies, predicts Harvard Business School professor Willy C. Shih.

In the 1990s, Shih ran Eastman Kodak's consumer digital products unit. He wanted to build a plant to make OLED displays, which Kodak had invented and patented two decades earlier. "We concluded we didn't have the support industries or workforce," he says. Sony and Samsung have since launched TVs with OLED screens. Kodak also has a product—a tiny OLED TV made under license by Kaga Electronics of Japan..

Soon such screens could be printed cheaply using a kind of inkjet technology. In the U.S., there's a new consortium for makers of large flexible displays, run by Daniel Gamota, a former Motorola executive. But Gamota thinks the first successful startups will be in Europe, where governments are investing in manufacturing processes. "Here in the U.S., we have all the pieces," Gamota says. "But there has been no concerted effort to bring those pieces together." *—Pete Engardio*



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INNOVATION & TECHNOLOGY

Oracle Has Customers Over a Barrel

As CEO Ellison tries to extend the company's reach into hardware, more corporate clients fret about its high prices and tough tactics



ILLUSTRATION BY JACK UNRUH, BASED ON A PHOTOGRAPH BY JOE PUGLIESE/CORBISOUTLINE

By Steve Hamm and Aaron Ricadela

Over the past four years, Oracle Chief Executive Lawrence J. Ellison has been on an acquisition binge that has brought all sorts of benefits to the company. After spending $30 billion to buy 56 companies, he has doubled the software giant's revenues to an estimated $24 billion this fiscal year and sent Oracle's stock surging. Ellison's latest deal is one of his most ambitious to date. His $7.4 billion offer for Sun Microsystems, which still needs approval from European regulators, would move Oracle into the hardware business for the first time and greatly expand Ellison's empire.

But the company's growing power, coupled with a surge in consolidation by other major players in the technology industry, has frustrated some corporate customers. They're concerned that Oracle's strategy is helping to stifle innovation and lock them into high prices. "Once you've made a deal with the devil, it's hard to get away," says James Sims, chief information officer of California grocer Save Mart Supermarkets, who says he's stuck with some Oracle products because it's too expensive to switch to alternatives. "They're extorting us. I'm very unhappy with them." Oracle declined to comment for this article.

It's not just Oracle that faces such customer conflicts. The wave of mergers and acquisitions in corporate computing over the past half-decade has been massive, with 79 purchases by Microsoft, 60 by IBM, 40 by EMC, and 34 by Hewlett-Packard. The $1 trillion business has come to be ruled by a dozen behemoths, and the software market is dominated by just four: Oracle, Microsoft, SAP, and IBM. Customers like the simplicity of buying technology from fewer suppliers, but they have also become more dependent on those companies. It's increasingly difficult to negotiate over price or shift to alternative technologies.

HOW TO PLAY IT 070

That dependence was one concern raised by European Union antitrust regulators on Sept. 3 when they launched a probe of the Sun deal. The issue: Sun owns MySQL, the leading open-source database software program, which is emerging as a competi-



tor to Oracle's world-leading database. If Oracle buys Sun, it could cripple or kill the rival product. "The Commission has an obligation to ensure that customers would not face reduced choice or higher prices as a result of this takeover," Competition Commissioner Neelie Kroes said in a statement.

The inquiry increases the uncertainty around the deal, leading some analysts to speculate that Oracle could pull out of the agreement. Still, the probe is unlikely to stop the transaction. If pressured, Oracle could sell MySQL or spin it out as an independent company.

The 65-year-old Ellison already wields enormous clout in the technology world, and that will only grow with the assets of Sun. If the deal goes through, he'll possess one of the widest ranges of products for corporations in the industry. Oracle will sell everything from server computers and data storage devices to operating systems, databases, and software for running accounting, sales, and supply-chain management. Ellison has hinted he may even develop applications for mobile phones and ultraportable netbooks. "The whole landscape of the industry could change," says Eric Openshaw, vice-chairman and U.S. technology leader for Deloitte Consulting.

RUNNING OUT OF TARGETS

The consolidation strategy is clearly paying off for Ellison and his shareholders. While the major U.S. stock indices are down slightly over the last five years, Oracle shares have more than doubled, to 22. Ellison's stock is now worth $25 billion, more than the $16 billion in Microsoft shares Bill Gates holds after giving $28 billion in stock to his personal foundation. Laura Lederman, an analyst at William Blair, says there's a strong correlation between the acquisition strategy and stock price performance. "The acquisitions make Oracle a more strategic supplier to its customers," says Lederman, who rates the stock outperform.

Some analysts have questioned whether the acquisition strategy is sustainable. The number of good, sizable potential targets is shrinking fast, which could mean tech giants that depend on takeovers for growth will

see their prospects dim. "When all the companies of size have been bought and the costs wrung out, this group will be very low-growth and boring," warns analyst Peter Goldmacher of securities firm Cowen & Co. Analysts are predicting that Oracle's first-quarter revenues, to be announced in two weeks, will be flat to down in part because it's the first quarter where the company won't get a big revenue boost from acquisitions.

AN ABOUT-FACE

For decades, Ellison had nothing but scorn for tech companies that bought growth. After co-founding Oracle with $2,000 in 1977, he often took swipes at rivals for "writing checks, not code." All that changed on June 6, 2003, when he launched a hostile takeover offer for rival PeopleSoft. During an interview that day with *BusinessWeek* in a suite at New York's Carlyle Hotel, Ellison called it the dawn of a new era in software. "There will be a handful of very large entrenched companies that will dominate the technology industry," he predicted.

The scene was classic Ellison. He was decked out in an exquisitely tailored gray suit and collarless black shirt. A Steinway baby grand served as a backdrop. Ellison argued the era of consolidation would be good for customers, too. With fewer suppliers, he said, customers could rely on the remaining players to manage the difficult task of stitching together different software programs, rather than handling the chore themselves. He also said larger companies would be able to invest more in next-generation products. "We're going to bend over backwards to make PeopleSoft customers happy," he said.

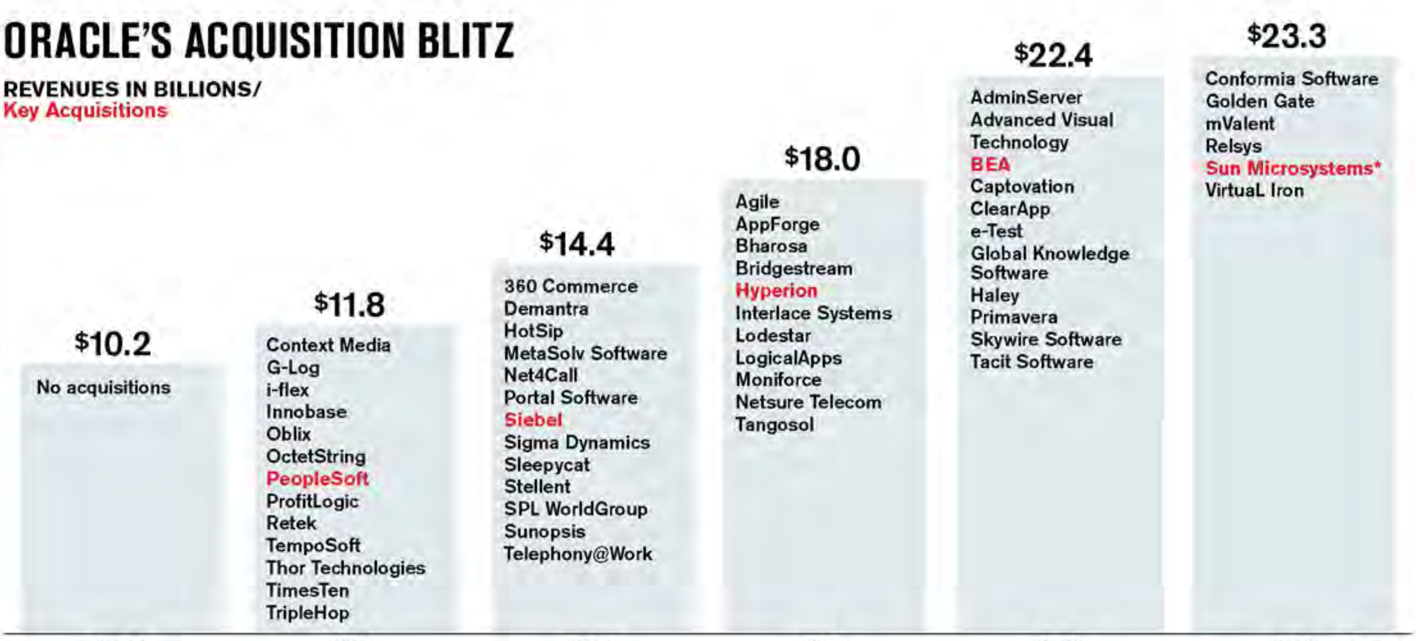
It was a pledge he made repeatedly as Oracle bought one software company after another. Ellison told customers it would support their products for years to come, and they didn't have to switch. At the same time, Oracle embarked on an ambitious development project, code-named Project Fusion. The idea was to rewrite all the software for its run-the-business applications, from accounting to planning, melding together the best features from products the company had acquired.

Some Oracle customers told *BusinessWeek* they are satisfied with the company and look forward to the Fusion applications. "We absolutely welcome them. We can take advantage of the unification of the applications," says Raymond Payne, president of the Oracle Applications Users Group, an association of Oracle customers. Ian Abramson, president of a similar organization, the Independent Oracle Users Group, acknowledged there's some frustration among customers with Oracle's high maintenance fees, but most understand the fees are necessary to pay for steady improvements to Oracle's products.



Other customers are fed up with what they call Oracle's high prices and tough tactics. Alaska Air Group had bought databases from Oracle and other applications from PeopleSoft, Siebel Systems, and Hyperion. Oracle later bought all those companies, leaving the airline stuck with a single supplier for all of its core technology. This year, because of the recession, Alaska Air Group renegotiated lower fees with every one of its software suppliers—

ORACLE'S ACQUISITION BLITZ



Data: Oracle

Note: Fiscal years, ending in May

PHOTOGRAPH BY PAUL SAKUMA/AP PHOTO; CHART BY ALBERTO MENA/BW



Ellison with Sun Chairman Scott McNealy shortly after they struck the deal

except Oracle. "They won't budge on pricing, and we're totally locked in," complains Kris Kutchera, vice-president for information technology at Alaska Air. "The bigger they've gotten, the stronger they've gotten, and it's harder for customers to get a deal."

Oracle has raised prices over the past couple of years, even as demand has softened along with the weak economy. The high-end edition of its database costs \$950 for each person authorized to use it, up 19% from two years ago. The price for Oracle software to run Web sites is up 17% in the same period.

AGGRESSIVE AUDITS?

One sore point with customers is the company's audits. Most software companies audit their customers occasionally, checking through their offices and tech systems to make sure they're paying for all the software they use. But Oracle has a reputation for being unusually aggressive, says Jane Disbrow, an analyst at Gartner Research. She says Oracle's policies can be confusing, and contracts with customers often don't clearly spell out their rights. As a result, some get presented with bills ranging from \$200,000 to \$4 million after they get audited. "It's easy to be out of compliance with Oracle licensing. They do nothing to help people stay in compliance," says Disbrow. "Then they audit you and hand you a big bill."

Some customers are fighting back. Sims, of Save Mart, says he could save 75% in annual maintenance fees if he were able to shift his computing systems to run on an open-source database provided by software company Ingres. But he feels he's stuck with Oracle for existing computing applications because it costs too much up front to switch technologies. Meanwhile, he's building all the new applications he can on the Ingres database.

The giant Japanese telecom provider Nippon Telegraph & Telephone is going even further. It's replacing many of its Oracle databases with another open-source package, PostgreSQL. Takeshi Tachi, a senior manager in NTT's Open Source Software Center, says PostgreSQL is now good enough to be used in some of the company's most critical computing systems. He expects NTT will save \$10 million a year with the switch. Ed Boyajian, CEO of EnterpriseDB, which sells PostgreSQL to NTT, says he's seen plenty of interest since Oracle said it was buying Sun and MySQL. "A lot of attention has shifted to us," he says.

Small and medium-sized software companies such as EnterpriseDB acknowledge they face major hurdles when they take on the giants, but they argue that they can play a vital counterbalancing role. "Technology purchasers are concerned that they'll be locked into a single vendor," says Sohaib Abbasi, chief executive of Informatica, a Redwood City (Calif.) company that sells software corporations use to manage their data. "We assure companies freedom of choice."

One trend that could increase the opportunity for software upstarts is the advent of so-called cloud computing. Over the long haul, experts believe many companies will shift from running computing tasks on their own servers to running them from remote server farms, or clouds, over the Internet. That shift may require software giants to sell their products in a new way, collecting fees over many months rather than pocketing huge checks up front as customers install the programs.

The change is also expected to make it easier for corporations to switch from one technology service provider to another. Oracle and the other software giants would have less power over customers. "Where the world is going and where Larry is going are in conflict," says Marc Benioff, chief executive of Salesforce.com, an Oracle competitor that delivers its software over the Net.

Still, corporate customers that feel squeezed by the giants may have to change their behavior if they really want more choice in the market. After the dot-com bust, corporations largely turned their backs on startups because some of them failed to deliver on their promises. To foster more innovation, customers may need to risk doing business with young companies again. "If they want to see new technology they'll have to be more open to the startups," says Marc Andreessen, the Internet pioneer who is now a venture capitalist. "They'll have to be more willing to experiment." | BW |

Business Exchange

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Is Larry Replaceable?
Larry Ellison has long been synonymous with Oracle, the software giant he co-founded and now leads as CEO. But is he irreplaceable? Forbes asks the question in a 2006 cover story that goes behind the scenes to examine how the company operates. Quick answer: He's not.

To read the story, go to **bx.businessweek.com/enterprise-software/reference/**

Will Social-Network Smartphones Click?

Motorola is betting that new mobile devices aimed at Twitter-types will reverse its dwindling fortunes

By Roger O. Crockett

Two years ago, Motorola's Rick Osterloh made a pitch to his bosses that almost got quashed before he left the room. In a 12th-floor conference room at Motorola's Schaumburg (Ill.) headquarters, the 37-year-old software executive proposed creating a line of phones that would use the Google-backed Android operating system and feature software designed for the budding world of social networking. As former Chief Executive Officer Edward J. Zander and current co-CEO Greg Brown listened, several top executives attacked the idea, arguing that Motorola already had too much complexity in its product lines. "There was controversy," says Osterloh.

Zander ultimately approved a modest investment. Now, Osterloh's idea is being used not just for one product line but as the leading example of the central strategy for Motorola's mobile-phone business. On Sept. 10 the company is unveiling the first model in its Android-powered line, a phone called Cliq. The phone uses Motorola-developed software, known as Blur, to create a social networking command center, combining every major service—MySpace, Twitter, Facebook, and more—on one screen. Postings can be typed and zipped to each site simultaneously with one swipe of the phone's touchscreen. Social networking features are embedded in everything from the phone's address book to its e-mail program. "The barrier between people's work and personal life is disappearing," Osterloh says. "We really tried to hit that sweet spot between consumer apps and work [programs]."

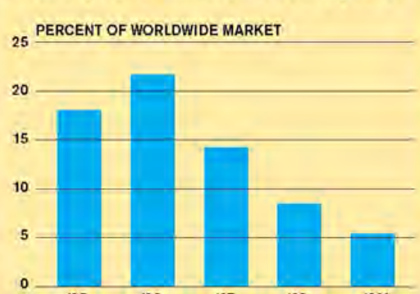


The notion that Motorola will try to distinguish itself with software is risky. The company has built standout hardware, from the first compact flip phone in the late 1990s, the StarTAC, to the dazzlingly slim Razr in 2004. But Motorola phones like the Rokr music phone and even the Razr were infamous for their clunky software. "Motorola has spent lots of time and money trying to develop the world's greatest software," says John Jackson, an analyst at the research firm CCS Insight. "But they haven't executed." With Blur, Motorola is betting it can reinvent itself as a master of both hardware and software.

Sanjay Jha, co-CEO and chief of the mobile-phone unit, is the man responsible for making sure this time is different. He has created a half dozen work teams to focus on specialized software areas, including social networking and location-based services. One group is concentrating on corporate e-mail, which suggests a

FALLING STAR

Motorola has lost share in the mobile-phone market in recent years



*Second quarter
Data: Strategy Analytics

ANDY FREEBERG



Osterloh's idea for a new line of phones is now a central part of Motorola's plans

clash with BlackBerry maker Research In Motion is on the horizon. Within a month, Motorola is expected to debut its second Android phone, for Verizon Wireless. Over the next year, Jha says Motorola will release phones in the U.S. and overseas that will reflect the breadth of its software development. No more "one-hit wonders," he vows. "If we do all of this we will have a machine that is sustainable."

Motorola needs a change in fortune. Once the world's dominant phone manufacturer, it has tumbled to the middle of the pack. It is No. 4 in market share behind Nokia, Samsung, and LG, dropping to a mere 5.4% share from 22.4% in 2006, according to researcher Strategy Analytics. In the fast-growing and lucrative smartphone category, Motorola has been surpassed by Apple and RIM.

It required a dose of California innovation to give Motorola hope for a turnaround. Osterloh joined the company as part of its acquisition of Silicon Valley's Good Technology in early 2007. And it took Jha, who left San Diego chipmaker Qualcomm for Motorola last year, to make smartphones the company's top priority.

PRIORITY E-MAIL

The commitment to an Android phone was clinched in a late October 2008 meeting in Motorola's Silicon Valley office, a short jaunt from Google's Mountain View (Calif.) headquarters. On a cool Thursday evening, Jha sat with Osterloh's team amid circuit boards, chipsets, and software schematics from 6 p.m. to 10 p.m. Over Diet Coke and pizza, they reviewed in detail what would become the Blur-equipped phone. After the meeting, Jha knew "this was a team that could take us places," he recalls. The Motorola co-CEO later killed off virtually all phones being developed for other operating systems, including Microsoft's Windows.

Jha pushed the software developers hard. He had Osterloh and his team redesign the phone's e-mail program several times because he told them it wasn't good enough. Jha had them tweak and retweak the keypad and find a way to increase the lines of visible text on the screen from 4 to 10, minimizing the need for scrolling. As people increasingly juggle work tasks during personal time, Jha wants to make e-mail as much a priority as social networking. "I wanted to be able to have broad appeal in the marketplace," he says.

After most of the software development was done, Osterloh and his team went to work lining up a wireless operator to carry the phone. In late January they pitched to T-Mobile at its Bellevue (Wash.) headquarters. The company's brass quickly agreed with Osterloh's vision that mobile messaging had to be simple and unified across online services. T-Mobile signed on to be the first carrier to offer the Cliq. "It sets a new benchmark for how people can stay connected to online communities," says Cole Brodman, T-Mobile's chief technology officer.

Motorola is betting the combination of Blur and Android will make social networking so much better for mobile users that its phones will stand out. Executives at MySpace have been impressed. Virtually every application on the phone links to MySpace features, such as Friend Status, where users update friends on their whereabouts. "Motorola was not confined to the existing rules on a platform," says John Faith, head of MySpace Mobile.

Blur may be a breakthrough for Motorola, given the company's historic lack of success in software. But it will still be a challenge to stand out against rivals such as Apple and RIM that have much more expertise in software. Jha says he recognizes the difficulty of the task. "We have to ask ourselves what problem do consumers want to be solved," he says. "We have to have a Neanderthal's focus on that." |BW|

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Android Rising

Mobile phones that use Google's Android operating system haven't received the recognition of flashier smartphones, such as the BlackBerry or Apple iPhone. But a flurry of Android phones will hit the market in the next few months. Besides Motorola, Samsung, LG, HTC, and Acer plan to debut devices, according to trade publication *eWeek*.

For the full story, go to **http://bx.businessweek.com/google-android**

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ECONOMICS & POLICY

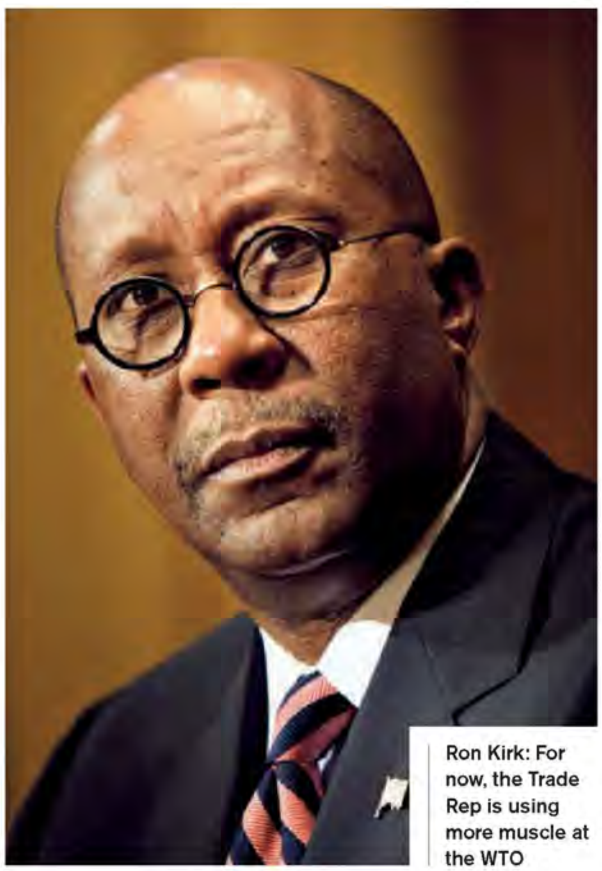
Free Trade In the Slow Lane

Why the White House is delaying deals with Panama and Colombia in favor of mending fences at home

By Steve LeVine

President Barack Obama's high-wire act on trade keeps getting harder to pull off.

When he assumed office, Obama had to deal with two opposing factions on trade inside his own party. Centrist Democrats favored more pacts with other countries to lower tariffs further on imports and secure more opportunities abroad for U.S. exporters. Progressive Democrats condemned the rapid expansion of free trade as a pernicious way to cost U.S. workers their jobs and move more industries offshore.



Ron Kirk: For now, the Trade Rep is using more muscle at the WTO

BRENDAN SMIALOWSKI/THE NEW YORK TIMES/REDUX

Early in his term, Obama favored the centrists. The President made it clear that the financial crisis would only worsen if free trade were in any way curtailed and trade wars broke out among the major economies. He and his U.S. Trade Representative, Ronald Kirk, signaled that a new trade accord with Panama was possible within months, while a pact with Colombia by year's end wasn't excluded. Drafts of both accords had been drawn up by the Bush Administration to lower trade barriers between the two Latin American countries and the U.S. The prospect of a Colombia pact especially angered progressives and their union allies, who charged the Colombian regime with harassing local labor groups.

Now neither deal appears likely this year or next. Free trade advocates have more hope that Obama and Kirk will push the World Trade Organization's global trade talks to a successful conclusion. The talks, known as the Doha Round, stalled last year over opening up the major emerging markets of India, China, and Brazil, and over reducing farm subsidies in the developed world. Kirk has engaged vigorously in the recently revived talks, but only wild

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optimists predict any major progress before the end of 2010.

What happened to Obama the free-trader? In the past eight months the President has used up a lot of the political capital he had with the progressives. The Democratic left wing now thinks he has favored corporate interests too often, from bailing out the banks to waffling on Wall Street bonuses.

Obama still needs the progressives to back him in the big battles

in exchange for signing Doha. The Administration has also doubled the size of a two-year-old intellectual property enforcement team within the State Dept.'s Bureau of Economic, Energy & Business Affairs. And the Senate is considering a bill to require the appointment of a trade compliance czar who would closely monitor existing trade agreements.

A key moment for trade policy comes on Sept. 17, when Obama must decide

TRADE: THE STATE OF PLAY

	ISSUE	STATUS
China	President Obama vowed to be tougher on trade issues with China	A Sept. 17 decision on cheap Chinese tire imports will signal how tough Obama is
Enforcement	The Administration has stressed enforcement over consummating new pacts	So far the USTR's record on enforcement is no tougher than its predecessors'
Doha	The White House says it supports completion of the latest round of global trade talks	The USTR wants commitments for lower tariffs before getting serious about Doha
Foreign Trade Agreements	Tentative pacts with Panama and Colombia were inherited from the Bush Administration	The U.S. continues to negotiate with the two countries, but agreements are stalled

Data: U.S. Trade Representative, *BusinessWeek*

over health-care reform and carbon emissions control. So before he risks antagonizing his left with free-trade initiatives, he has to establish his bona fides as a protector of U.S. jobs. "It is important that the Administration spell out its overall trade policy, how to spread its benefits," says Representative Sander Levin (D-Mich.), the influential chairman of the House subcommittee on trade, through which new trade legislation passes. Levin wants to enforce existing agreements and get stricter on future deals.

CHOOSING SIDES

No surprise, then, that Kirk is getting tougher. The USTR's office has filed a complaint with the World Trade Organization against China's decision to limit exports of raw materials needed by U.S. steel and chemicals manufacturers. In early September, Kirk demanded better access for U.S. banks and insurers to Brazil, China, and India

whether to punish companies exporting tires from China. In July the U.S. International Trade Commission recommended a three-year tariff of up to 55% on Chinese tires, agreeing with a United Steelworkers complaint that the imports unfairly deprived U.S.-made tires of market share and cost American jobs.

Coming just before Obama meets Chinese President Hu Jintao at the Group of 20 Summit in Pittsburgh, the decision will force the President to side with his labor constituency or with a much needed trading partner. The betting is he'll back the USW: A possible settlement would have China voluntarily reduce its tire exports. One State Dept. trade official says Obama needs to decide not just the tire case but another one or two big complaints in labor's favor: "[The President] needs to demonstrate to Congress that he gets the message that American workers are concerned about their jobs—and an unfair playing field in trade." |BW|

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Lower Your Taxes: Come to Switzerland

Multinationals, hedge funds, and private equity firms—spooked by rising taxes—are flocking to the Alps

By Kerry Capell

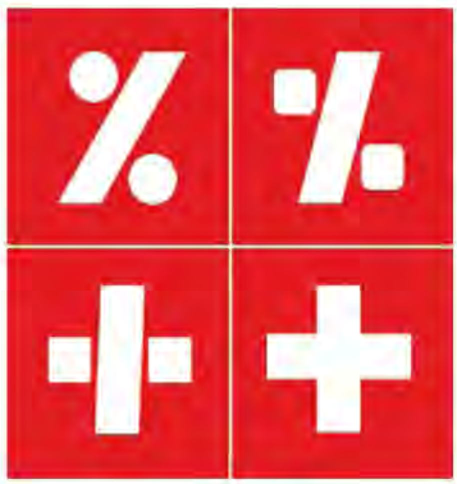


As governments around the globe struggle to contain huge deficits, companies and executives are bracing for higher taxes. And increasingly they are turning to Switzerland for relief.

This isn't the Switzerland of shadowy private banking, the kind that got Zurich giant UBS into trouble when it was forced to reveal details of American account holders suspected of tax evasion. Instead, Swiss cantons are openly and legally urging multinationals to relocate. This fall, U.S. fast-food giant McDonald's will move its European headquarters to Geneva from London, joining Kraft Foods, Yahoo!, and Nissan. They've all relocated their main Europe offices to Switzerland in the last two years to take advantage of low corporate taxes.

A highly skilled workforce, leading universities, and strong intellectual-property laws also attract companies. Yet those low taxes are very much part of the lure. "There is a lot of interest from companies looking to shift their taxable profit to countries with lower rates," says Andreas Müller, an international corporate tax partner at KPMG in Zurich. Meanwhile, Britain and Ireland are increasing personal income tax rates for top earners. In the U.S., tax hikes seem inevitable. Switzerland has no such plans, says Stéphane Garelli, professor of competitiveness at IMD Business School in Lausanne.

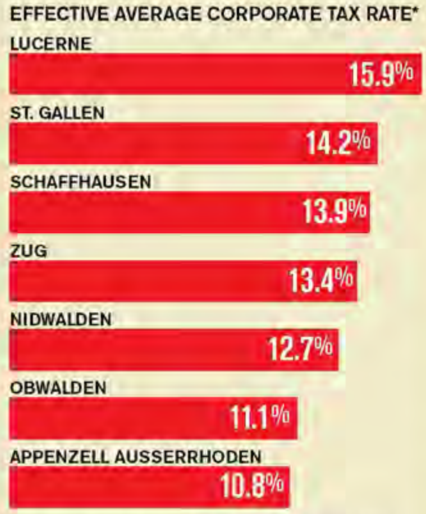
The 26 Swiss cantons are free to set their own rates, so Swiss-based companies' effective average tax rates range from 10.8% to 24% of net income (those effective rates include federal taxes, which are the same throughout the country). Ten cantons even cut rates in 2008 to lure investment. After slashing its corporate rate to 6.6% in 2006, the canton of Obwalden lowered rates to 6% last year, just after the nearby canton of Appenzell Ausserrhoden did the same. "A company might pay 50% less tax just by moving 30 miles down the road," says Martin Naville, CEO of the Swiss-American Chamber of Commerce in Zurich.



CORPORATE TAXES, SWISS-STYLE

Companies based in various Swiss cantons pay low rates

EFFECTIVE AVERAGE CORPORATE TAX RATE*



* Effective average tax rate on a profitable investment. Includes corporate tax, other profit-related taxes, real estate taxes, and other taxes based on capital as well as depreciation rules.

Rates as of January 2009.

Data: Bakbasel

OFFSHORE ALTERNATIVE

The Swiss enjoy other tax advantages. Unlike Bermuda and the Cayman Islands, Switzerland has a network of tax treaties. Under those treaties, Switzerland credits corporate taxes paid elsewhere against the taxes owed to the Swiss.

Washington may now tighten restrictions on companies headquartered in jurisdictions that do not have full tax treaties with the U.S. As a result, "there's a trend away from traditional offshore [havens] to countries with tax treaties with the U.S.," says Daniel Küng, CEO of Swiss business development agency OSEC in Zurich. Since last year five U.S. companies, including Tyco International, have moved headquarters from Bermuda and the Caymans to Switzerland for tax reasons.

While the Swiss court companies, the British unwittingly help the Swiss out. As of last year, foreigners living in the U.K. for seven years or more must pay tax on income and capital gains earned outside Britain or fork over an annual $49,000 on top of what they ordinarily owe the government. And starting next April, the top income tax rate will jump to 51.5%, including social security payments. That's up from 40% for anyone, citizen or foreign resident, earning more than $245,000. The hikes have prompted some hedge funds and private equity firms to head to Switzerland, analysts say. Krom River, a commodities fund with $750 million under management, moved to the canton of Zug last year. The lure: Swiss stability. "Companies can be sure that once they invest, there won't be any surprises," says Naville. |BW|

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The Six Sigma Black Belts Are Back

Everyone from retailers to drugmakers is using the efficiency discipline to squeeze out more savings

By Brian Burnsed and Emily Thornton

Here's one more reason why the world may face a jobless recovery: Six Sigma. In an attempt to boost earnings without putting more people on the payroll, companies are embracing the controversial data-driven system that aims to radically reduce production defects and improve processes in everything from marketing to manufacturing.

Companies as varied as drug giant Merck, British confectioner Cadbury, and doughnut maker Dunkin' Brands are increasingly turning to Six Sigma to lift their bottom lines. Capital One says it has launched a Six Sigma initiative to "drive continuous improvement" in its operations, while Pfizer this year embarked on 85 Six Sigma projects to lower the cost of delivering medicines to patients in its pharmaceutical sciences division. "We're applying Lean Six Sigma across the whole R&D process," says Pfizer Senior Vice-President Annette Doherty. (Lean Six Sigma includes elements of lean manufacturing techniques.) Even the Chicago law firm Seyfarth Shaw has become a Six Sigma devotee, with Managing Partner J. Stephen Poor calling it "a very powerful tool" in making client meetings more productive.

Such interest speaks to the level of anxiety permeating the corporate landscape. Six Sigma expert Anand Sharma, CEO of TBM Consulting Group, says that "in the last 90 days we have had 50% more inquiries and proposals out than ever before." Ads seeking Six Sigma experts and "black belts" increased to 7,155 in August from 6,585 in June, according to job site aggregator Indeed.com.

Faced with the prospect of lackluster sales through the end of the year, leaders are looking for alternative routes to growth. "When you know the result of your cost-cutting efforts will be letting go 15% of your workforce, you don't need a consultant," says David Silverstein, CEO of consultancy Breakthrough Management Group International. While heavy layoffs and cost-cutting helped boost earnings in the second quarter, many companies are now so tightly managed that further gains may be tougher to come by.

Thus the renewed interest in Six Sigma and its emphasis on rigorously measuring and perfecting various processes. Unlike in the 1990s, when such executives as General Electric's Jack Welch embraced Six Sigma with missionary zeal, consultants say today's converts generally are looking for a fast way to save money. "We've really seen in the past 12 to 18 months that companies that want Lean Six Sigma want something very different," says Mark O. George, managing director in the Process & Innovation Performance group at Accenture. Instead of the kind of cultural change often associated with a Six Sigma initiative, they're looking for techniques that can pay off quickly. David Niles, president of Six Sigma consultancy SSA & Co., says clients now tell him, "'What I really want is results, and I want them in 90 days.'"



TIM LANE

Critics say Six Sigma has its drawbacks. They argue its obsessive focus on measurements can squelch innovation or prove ill-suited to processes away from the factory floor. And

investments can take many months, if not years, to pay off. "If you're thinking about it being useful for the current economic downturn, it may be a little late to start a lot of Six Sigma work," says Thomas Davenport, a professor of management at Babson College.

Still, Six Sigma is finding new life, especially in retail. Target claims more than $100 million in savings over the past six years from the program. Mike Fisher, Best Buy's senior director of Lean Six Sigma, says projects like streamlining appliance installation have helped the company save up to $20 million in some cases. "Without a doubt, it put us in a better position to muscle through the recession by getting all of those inefficiencies out," says Fisher. SSA has helped several retailers expand programs in the past year. Retail practice leader Suzanne Long says that three national retail chains are among the consultancy's new clients.

For a sense of the new approach to Six Sigma, consider Target. It hasn't enforced its program with the rigor common in manufacturing. "Some companies require their employees to use Six Sigma," says spokesperson Beth Hanson. "You don't have to be a black belt or green belt or be certified at all to use Six Sigma [here]. We just offer employees the tools." | BW |

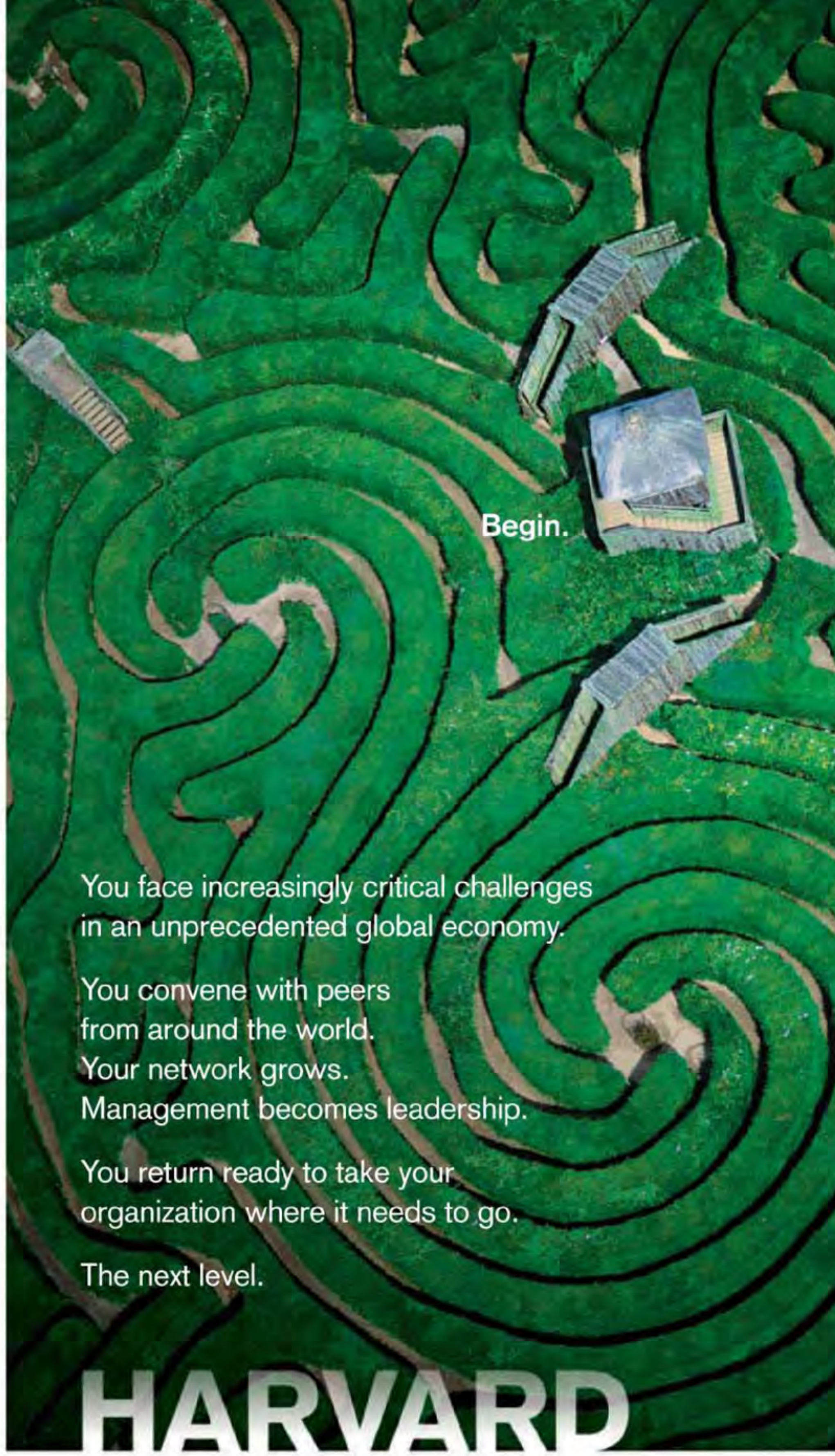
Business Exchange

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Lean Thoughts for Lean Times

For devotees of Six Sigma there's no shortage of online resources. One of the most globally minded of the blogs on the subject is Six Sigma (sixsig.info). Recent posts touch on Six Sigma's applicability in the health-care industry and include a story on how an Indian wind power company is deploying lean manufacturing techniques.

To check out the blog, go to **http://bx.businessweek.com/lean-six-sigma/reference/**



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Snyder of The Cartoon Network: Advertisers like its new boy-centric shows

STRATEGY & COMPETITION

The Struggle to Get Boys' Attention

Behind Disney's Marvel deal is the feverish pursuit of increasingly distracted young males

By Tom Lowry and Ronald Grover

Ask media executives what audience they covet most these days and they will likely tell you: boys. The U.S. has 30 million males aged 5 to 19, and capturing their attention with a TV show, movie, or magazine article is a boon to advertisers. Boys (or their parental proxies) are ravenous consumers who spend billions each year on apparel, toys, and video games.

On the other hand, boys are easily distracted and much harder to reach than girls. Big Media, faced with the loss of auto and financial advertising, is charging hard at this elusive demographic. Exhibit A: Walt Disney's $4 billion acquisition of Marvel Entertainment and all its superheroes. Besides attracting more boys and balancing out Disney's big following among girls, the Mouse House believes the Marvel acquisition will bolster Disney XD, a channel it is now using to target boys. News Corp., Time Warner, and others are doubling down on young males, too. "There are not that many media vehicles to reach boys," says Jill Steinberg, chief marketer at the video game maker Ubisoft. "So when you find options where boys gather, you take advantage of that."

MORE ABOUT ME, PLEASE

When ratings at Time Warner's Cartoon Network began to falter last year, the channel decided it needed to find new ways to reach young males. "In our focus groups, we were hearing that boys wanted to see more of themselves on-air," says Stuart Snyder, who heads the network. So Cartoon added more live-action shows to its animation mix. In mid-August, Cartoon premiered its two latest shows, *Bobb'e Says*, about a kid who goes around telling people what not to do, and *Dude, What Would Happen*, about three curious teens who conduct quirky science experiments. Shortly after, Cartoon had three shows in the top 10 most viewed programs for boys in prime-time cable. These and other boy-centric offerings have been greeted favorably by Cartoon's stable of advertisers, which includes cereal maker General Mills, Mattel, and Lego. The latter created tie-in toys for George Lucas' *Star Wars: The Clone Wars* program that airs on the cable network.

Cartoon is even beginning to dabble in sports programming, traditionally watched by boys with a parent. The channel is betting it can get boys to watch sports together. That's why it teamed up with the NBA to create *My Dad's A Pro*, a series following the children of professional basketball players. In turn, Cartoon will launch a basketball section on its Web site, already loaded with video and online games.

News Corp.'s FUELTV, an action sports channel for ages 13-24, has attracted such advertisers as Mountain Dew, Red Bull, and game maker Electronic Arts. But the channel is currently seen in only about a third of U.S. homes. General manager CJ Olivares hopes a Saturday morning block of shows aimed at the 13-and-under cohort will give FUELTV a wider appeal. One show, *New Pollution*, is hosted by pro surfer Matt Beacham, who introduces a new generation of action sports stars. *Camp Woodward* gives boys a glimpse into the inner workings of a camp for kids interested in action sports.

Even magazines are finding pockets of strength in the young male market. *Sports Illustrated*'s *SI Kids* is a 1 million-circulation spinoff whose readership is more than three-quarters boys. In recent years, *SI Kids* has added special editions, including one that anoints the best kid athlete of the year and another about video games. Going even more niche with boys seems to be paying off. Advertising pages at *SI Kids* were up nearly 5% in the first half of 2009—a rare feat in this economy. |BW|

ANN STATES

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PERSONAL BUSINESS

MONEY REPORT

BANK ON THESE

Even by today's standards of volatility, the week of Aug. 31 was a crazy one for bank stocks. Citigroup and Bank of America fell nearly 10% by midweek, only to rebound later. David Ellison, manager of FBR Small Cap Financial Fund and FBR Large Cap Financial Fund, went 60% to cash before the financial crisis. Now he says over the next five years the banking sector "will go from ugly to O.K. to good to great." He suggests buying the 8 or 10 banks with the most in deposits (table) since they'll be able to make loans and acquire other banking assets on the cheap. "There's going to be a premium placed on [banks with] those deposits," he says. Some top names in his large-cap fund: Bank of America, JPMorgan Chase, SunTrust Banks, Wells Fargo, PNC Financial Services Group, and Comerica. *–Amy Feldman*

WHO HAS THE DEPOSITS?

COMPANY/TICKER	U.S. DEPOSITS (BILLIONS)
Bank of America/BAC	$901.0
Wells Fargo/WFC	763.8
JPMorgan Chase/JPM	626.1
Citigroup/C	311.3
PNC Financial Svcs. Group/PNC	186.9
U.S. Bancorp/USB	151.3
SunTrust Banks/STI	118.3
BB&T/BBT*	114.9
Capital One Financial/COF	114.4
TD Banknorth**/TD	104.7

*Data for BB&T reflect the Aug. 14 government-assisted acquisition of Colonial Bank. As of June 30, Colonial Bank had U.S. deposits of $20 billion. **Subsidiary of Toronto-Dominion Bank. Data: SNL Financial; based on June 30 regulatory reports filed by top-tier consolidated bank holding companies, commercial banks, savings banks, and savings institutions.

DEALS

A BARGAIN BUFFETT?

Warren Buffett is up to his old dealmaking ways. On Sept. 2, Berkshire Hathaway partnered with Leucadia National to buy the mortgage business of Capmark Financial Group. But Berkshire's shares are flat in 2009, while the Standard & Poor's 500-stock index is up 14.6%. Shares fell 51% before leveling in March.

51%

Fall in shares of Berkshire Hathaway from October 2008 to March 2009

Data: Bloomberg

Buffett loaded up on ConocoPhillips as oil peaked. In November his foray into derivatives soured. Berkshire lost its AAA credit rating when Fitch downgraded it in March. But now investments in General Electric and Goldman Sachs, which yield 10% annually and can be converted to stock, look shrewd. Its insurance business still bests rivals, notes Jerome Heppelmann, manager of Old Mutual Focused Fund, who has 5% of the fund in the stock. At Geico the number of new policies grew by nearly 11%, at a time of industry contraction. *–Ben Levisohn*

STOCKS

PET PROFITS

Shares of Del Monte Foods opened 10% higher on Sept. 3 on a report of record first-quarter profits. The food and pet-products company (not to be confused with Fresh Del Monte Produce) hiked its earnings estimate 15% for the rest of the fiscal year. "Pricing has finally ... exceeded the years of commodity-cost inflation that pummeled [their] profit margins," according to Credit Suisse analyst Robert Moskow. Although sales growth is expected to stay positive, he thinks the stock, at 11.48, can rise only to 12. Morgan Stanley analyst Vincent Andrews says that over the past two years, Del Monte and rivals have benefited by up to 2% growth a year from people eating out less. He calls such growth "ultimately unsustainable." Profit margins will likely fall since Del Monte plans to up marketing spending 40% to 50%, making the stock, at 10% below its 2007 peak, a hard sell. But CreditSights likes its 2015 bonds, which trade at a small discount.
–Tara Kalwarski



MANAGED FUTURES

A FAST-PACED TRADING GAME

By Ben Levisohn



In 2008 few hedge fund strategies performed better than managed futures, which attempt to profit from short-term moves in commodity, currency, and other markets. And in 2009 few have performed worse. Does that mean it's time to bail out on managed futures?

If one looks simply at returns, it might seem so. The category is down 7.8% through the end of July (the most recent data available), according to Altegris Investments, a broker-dealer based in La Jolla, Calif. That's lousy compared with the Standard & Poor's 500-stock index's 9.3% gain over the same period—and with the 15.5% return that managed futures posted in the midst of last year's market meltdown. Such stellar performance in 2008 had some proponents calling managed futures "the new diversifier." And while this year's numbers aren't pretty, the fact that the category hasn't moved in lockstep with the market is actually better for your portfolio. "The funds are doing what you'd expect them to do," says Adam Erickson, chief operating officer at Brewer Investment Group, a Chicago wealth management firm. "They're not following the stock market."

The funds' managers, who are also referred to as commodity trading advisers, buy and sell futures contracts in everything from oil and natural gas to currencies and interest rates. They hope to profit from large price moves, up or down, over a few weeks or months, and they usually do so with the help of complicated computer programs that help identify trends.

-7.8%

Loss in 2009* by managed futures funds

*Through July
Data: Altegris Investments

9.3%

Gain in 2009* for the S&P 500

*Through July
Data: Bloomberg

If you buy managed futures, don't expect a smooth ride—they have "a little bit higher volatility than people are aware of"

"They're good at capturing large price movements in commodities and currencies," says David Bailin, president of alternative investments at Merrill Lynch Wealth Management.

But this year has been noticeable for its lack of pronounced—and sustained—market movements. Until it recently spiked above $1,000 an ounce, gold had spent much of the year trading in the 900s. The euro has been stuck in a 6¢ range against the dollar since May. And even when there have been moves—oil's bounce from $45.20 to a recent $71.10 is a good example—they've been sudden, uneven, and short-lived. "There's been talk of double dips and green shoots, inflation and deflation, and plenty of stutter steps and reversals," says Altegris President Jon Sundt, referring to the market's mixed signals. "It's the choppiness of the market that's responsible for the performance."

So investors in managed futures shouldn't expect a smooth ride. Managers often lose small amounts of money as their computer models identify possible trends that fail to materialize.

EDEL RODRIGUEZ



But when the trends do emerge, they can often make up for the losses. In every year since 2000, Altegris' managed futures index has had periods in which it fell 6% or more yet still finished up for the year. Last year's gains came despite a 7% loss during the summer. Says James Shelton, chief investment officer at Kanaly Trust: "The investment itself has a little bit higher volatility than people are aware of." Merrill Lynch says managed futures make up about 2% of its high-net-worth investors' portfolios. Some advisers recommend going as high as 15%.

PINTO VS. LEXUS

Once available only to accredited investors—those who make $250,000 a year or have $1 million in investable assets—managed futures are now an option for everyday investors. In recent years, mutual funds have emerged that seek to track the strategies of managed futures. Rydex/SGI Managed Futures Fund, which came out in 2007, mirrors the performance of the S&P Commodity Trends Indicator, an index that uses a seven-month moving average (the average daily price of an asset over a seven-month period) to decide when to buy or sell any of six commodities, six currencies, and Treasury bonds or notes. Direxion Commodity Trends Strategy Fund and Direxion Financial Trends Strategy Fund, introduced last year, take the Rydex fund but separate the commodity and currency components. Other firms, including WisdomTree Investment and AQR Funds, have recently applied to the Securities & Exchange Commission to launch their own managed futures funds.

The Rydex fund was up nearly 9% in 2008 and is down 3.9% so far in 2009—not as stellar as some managed futures funds, but not too shabby, either. To comply with SEC regulations the funds place trades based on a set of simple, unchanging rules once a month rather than using the complex, constantly adjusting mathematical models of the best-managed futures programs—making them a sort of "managed futures lite" option. They're also designed not to short energy futures, which are more sensitive to economic and political events. While that decision reduces overall volatility, it also means the mutual funds don't profit when oil crashes, as it did in 2008. "The difference between the two types of funds is like a Ford Pinto and a new Lexus," says Ken Steben, president of managed futures adviser Steben & Co. in Rockville, Md. "They both run on combustion engines, but the cars are very, very different."

For investors interested in more traditional managed futures, some commodity trading advisers make their funds available to investors who make at least $70,000 a year and have $70,000 in investable assets. But choosing a manager isn't easy—each has his own proprietary computer program and favored strategies, and the difference in performance among managers can be huge. In 2008 the best managed futures funds were up more than 30%, while the worst were down around 20%. And the funds may come with the high fees associated with hedge funds—it's not uncommon for 20% of the profits to go to the manager—and do not have daily liquidity. Focus on experienced managers and try to get a feel for how much risk they take on to generate their returns. Says Altegris' Sundt: "Do your homework." |BW|

WAYS TO PLAY MANAGED FUTURES

MANAGED ACCOUNT

MINIMUM $250,000

PRO Keeps investor money in separate accounts, which provides flexibility in terms of strategies and leverage.

CON Depending on the manager's aggressiveness, the investor can lose more than originally invested.

PRIVATE COMMODITY POOL

MINIMUM $25,000

PRO Provides access to the most current and intricate strategies.

CON Commodity pools usually have large minimum investments and are available only to accredited investors.

FUND OF FUNDS

MINIMUM $25,000

PRO Diversifies an investor's money with multiple commodity trading advisers, which theoretically cuts risk.

CON Adds another layer of fees to already expensive funds.

PUBLIC OFFERING

MINIMUM $10,000

PRO Open to people who make at least $70,000 and have $70,000 in investable assets; it's SEC-registered, and its strategies may be less risky.

CON Fees are complex, and you can buy or sell only once a month.

MUTUAL FUND

MINIMUM $2,500

PRO The minimums are low, and you can buy or sell your fund daily.

CON To meet SEC requirements, funds use watered-down strategies that are a far cry from complex programs run in most managed futures accounts.

Oracle Has Customers Over a Barrel

(FROM PAGE 052)

By Aaron Pressman

The conventional wisdom used to be that investors should run from technology companies that did too many mergers and acquisitions. But over the past decade, a group of top-tier tech wheelers and dealers has emerged that increased shareholder value with their acquisitiveness. Companies such as Oracle, IBM, and Adobe Systems have successfully used acquisitions to get into new lines of business, expand their customer bases, and grab hot new technologies. Still, some companies consistently overpay or buy yesterday's big breakthrough. An informal survey of tech fund managers, analysts, and consultants yielded a list of companies investors will likely favor on more deal news—and a few they may shun.



Once mainly a hardware vendor of computers large and small, **IBM** has used a sharp acquisition strategy to expand into software and information technology services. After a string of successful additions, including performance management software maker Cognos, and Rational, which makes tools to help programmers write code, IBM announced in July it would pay $1.2 billion for SPSS, a leading developer of software to analyze statistical data. "All the software acquisitions have helped shift the company toward higher margins and faster growing areas," says Ken Allen, manager of the T. Rowe Price Science & Technology Fund. IBM was his 15th largest holding as of June 30.

Salesforce.com has always been a poster child for the move from desktop applications to Web-based products. As more computing and data storage have migrated to online servers—the clouds in "cloud computing"—Salesforce has used a series of small acquisitions to keep pace. In 2006 it grabbed wireless software developer Sendia, for example, helping make all its offerings available over mobile phones. "They're doing a good job of pushing each acquisition into their services," says Jeff Kaplan, founder of tech consulting firm Thinkstrategies.

Cisco Systems is the king of bolt-on acquisitions. In a typical deal, Cisco purchases a much smaller company, such as voice-over-Internet gearmaker Sipura, which it bought for $68 million in 2005. Then it uses its manufacturing smarts and sales force to promote cutting-edge products that often fit into existing lines of business. Cisco also uses purchases to diversify and get into new businesses. This year it added Pure Digital Technologies, maker of the Flip digital video camera. "Their goal is to become a larger player in the consumer electronics and networking business," says Ned Douthat, an analyst at Ockham Research in Roswell, Ga.

One company that Richard Parower, manager of the Seligman Global Technology Fund, says never quite makes the right deal at the right price is **Microsoft**—"the one glaring example of [tech companies] that can't do acquisitions." For example, Microsoft paid more than $6 billion for Web advertising company aQuantive, a price several investors say was far too high. And its on-again, off-again talks to buy Yahoo! have shareholders worried about another surprise deal. T. Rowe's Allen thinks "investors are still discounting the probability they'll do something so risky again." A Microsoft spokesman says: "We buy where it makes sense, where we can accelerate growth, and generally we buy companies early in their history."

Another loser, say investors, is mobile-phone manufacturer **Motorola**. "Remember Symbol Technologies and Good Technology, both acquired by Motorola?" says Eric Jackson, founder of Naples (Fla.) money manager Ironfire Capital. "They have disappeared off the face of the tech landscape." Motorola says it's pleased with both deals and notes that Good's programmers are central to building products that use Google's Android mobile-phone software. | BW |

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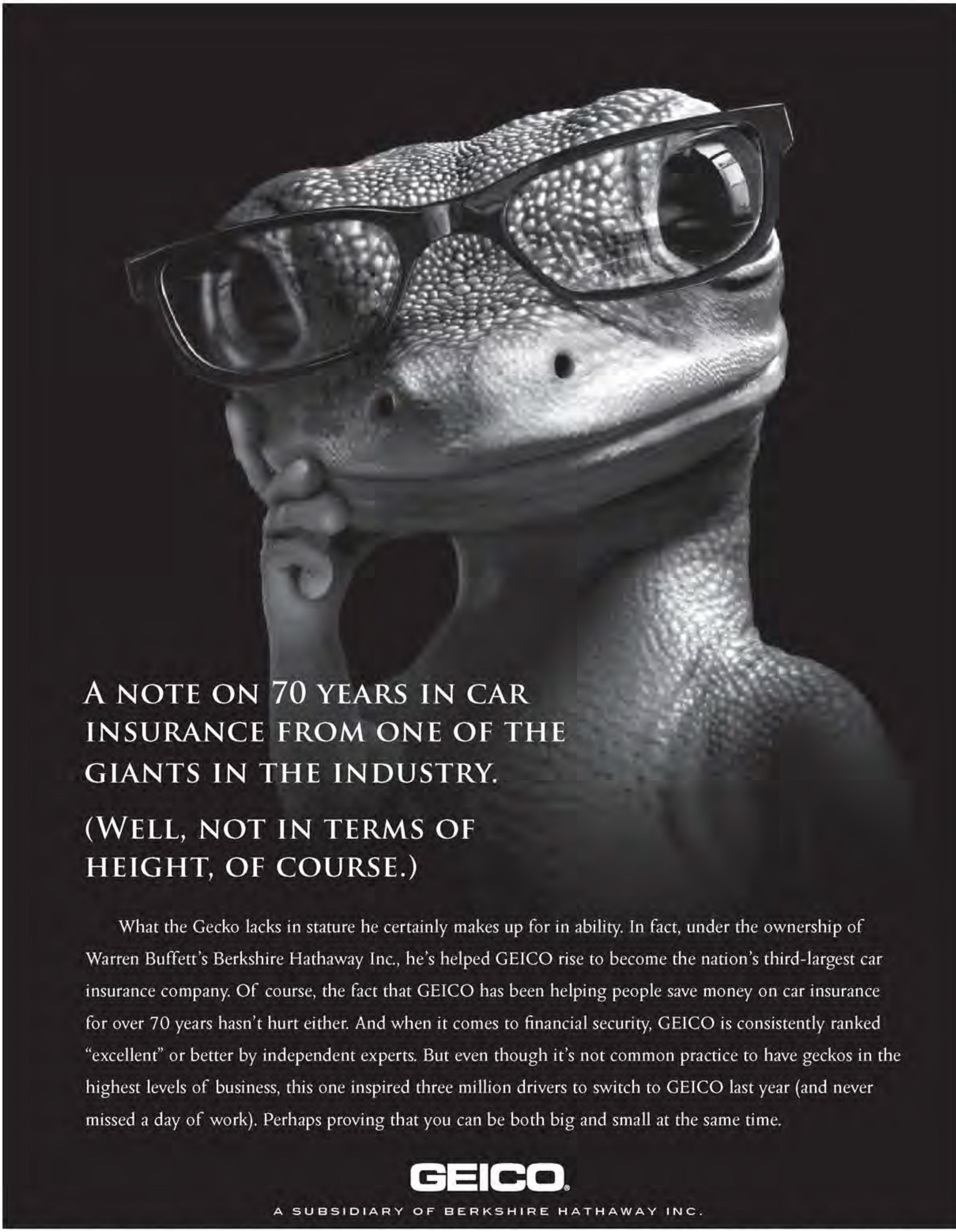
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GAP IS LOOKING SPIFFY

Gap (GPS) is back in more ways than one. Not only is the apparel giant spending big to push new products at its Gap and Old Navy stores, but it's also keeping a lid on other expenses to fatten margins. The strategy is working: Second-quarter results beat Street forecasts, and shares have leaped to 21.56 from 9 in just 10 months.



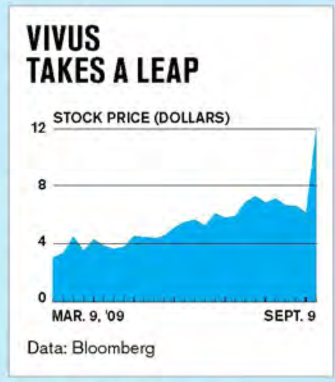
Data: Bloomberg

"The Gap is finally moving from defense to offense in driving up sales," says Edward Yruma of KeyBanc Capital Markets (it seeks to do business with Gap). He has upgraded his rating to buy from hold and notes that Gap plans to boost third-quarter marketing outlays by $25 million, to $147 million. Despite the heavy promotional spending, margins have stayed strong, notes Yruma. He forecasts earnings of $1.32 a share in 2009 and $1.46 in 2010, vs. 1.34 in 2008.

Gap operates more than 3,100 stores, including Old Navy, Banana Republic, and GapKids, in the U.S., Canada, Western Europe, and Asia. International sales account for 15% of total revenues. "Gap's strong free-cash-flow generation and its debt-free balance sheet differentiate it as one of the higher-quality companies in retail," says Lorraine Hutchinson of Bank of America Merrill Lynch (it has done banking for Gap), who rates it a buy. "It has taken the right steps in a difficult environment," she adds.

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Data: Bloomberg

From Vivus, a New Obesity Drug

Vivus (VVUS) is sparking big interest in its obesity drug, Qnexa. Vivus just completed two Phase 3 clinical trials that showed positive results and will justify a new-drug application to the FDA. "We are confident Qnexa will gain approval in 2011," says Jason Butler of JMP Securities (it seeks to do business with Vivus), who rates Vivus outperform. He sees Qnexa sales of $1.5 billion in 2015.

Qnexa is an oral, low-dose drug for weight loss. The studies revealed that patients on Qnexa for 56 weeks lost 37 pounds on average. Vivus is seeking a large drug partner for the launch of Qnexa. Butler sees the company, whose stock soared to 11.80 on Sept. 9 in the wake of news reports of the trial data, posting earnings of $1.68 a share by 2014.

Marc Robins of research group Robins Group (it owns shares) says Vivus will be further bolstered by the announcement of a partner or joint venture for Qnexa.



Data: Bloomberg

3M Posts Recovery Notes

3M (MMM), a global diversified company that makes such household and office products as Scotch tape, Post-it notes, and Nexcare adhesive bandages, has felt the recession's cold wind on its sales. But recently the stock, a component of the Dow Jones industrial average, has been on a tear, hitting 73.83 on Sept. 9, up from a 52-week low of 40 on Mar. 6. Some pros see more firepower in the stock as the economy recovers.

Zacks Investment Research upgraded its rating to outperform, based in part on 3M's second-quarter results, which beat analysts' forecasts. An increased focus on emerging markets in China and India, says Zacks, will brighten its prospects.

Mathew Christy of Standard & Poor's, who rates 3M a buy, says the stock is "attractively valued." He sees it at 81 in a year, based on his earnings estimate of $4.24 a share in 2009 and $4.59 in 2010. |BW|

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BUSINESS VIEWS

MEDIA CENTRIC | JON FINE



What to Watch While I'm Away

Ad spending has seen its low. The print playing field will shrink. The mightiest won't fall



BRAD TRENT; ILLUSTRATION BY JAMES STEINBERG

This will be my last column before I take several months off to travel and check out life and media in other corners of the globe. During my absence from these pages, of course, the world of media and marketing will stop revolving and remain utterly rooted in place waiting patiently for my return.

Riiiight.

Many trendlines that will play out over the next several months are evident right now. Media companies foolish enough to have taken on massive debt to buy declining businesses between 2005 and 2007 will continue struggling to digest it, as radio giants Citadel Broadcasting and Clear Channel Communications are doing.

The economy will continue wheezing its way back into the "new normal" we keep hearing so much about. The brutality of the advertising market in the first half of this year—with its 15.4% drop in U.S. ad spending, per Nielsen, worse than many expected—will prove to be the market nadir, but its effects nonetheless will continue to ripple. What will the next several months bring?

The ongoing remaking of weaker media sectors. There will be fewer magazines. (This one likely will be owned by another company, but that's another story.) What happened to city

newspapers—the gaggle winnowed down to one survivor—will start happening in 2010 at a regional level. Look for the strongest player to outlast weaker rivals in towns and small cities near one another.

Surprising stability among the biggest players. For all the ills ascribed to big multimedia conglomerates CBS, News Corp., Time Warner, NBC Universal, Viacom, and Disney, for their slow-motion shifts and ill-timed investments, none are in as grim shape as the overly indebted and now bankrupt Tribune Co. Whatever results from this latest ad drought, the tallest trees won't be the ones that fall. But note that Disney, the company least dependent on ad dollars, and one that had recently avoided deals that the Street might wrinkle its nose at, pulled off the biggest and most interesting move of the year: a $4 billion acquisition of Marvel Entertainment. Expect the next big deal to come from Viacom—whose cable TV assets are among the least-bad traditional businesses going. Or from a soon-to-be-post-AOL Time Warner, assuming its CEO, Jeff Bewkes, isn't rendered gun-shy by the bad reaction to his overpriced purchase of social network Bebo in March 2008.

Which is closely related to how **a bright line divides media haves from have-nots.** You can find it by posing a simple question: Do you have something people will pay meaningful sums for? If you're in terrestrial radio, newspapers, or magazines, generally the answer is no. They're free online, or almost insultingly cheap to subscribe to. (There are some exceptions: *The New York Times* and *The Wall Street Journal*—which also charges people to read articles online—are relatively pricey subscriptions, as are rare magazines such as *The Economist* or *People*).

If you have movies, data, theme parks, TV programming, or cable properties, the answer is yes. (Note here that virtually all of the biggest conglomerates do not have big print operations, save for News Corp. and Time Warner.) The players on the wrong side of this line are eager, if not desperate, to switch sides. This is why so many publishers are intrigued with two new startups—Journalism Online and ViewPass—that are pitching different means to charge users for online content. A year from now, we will know which players, if any, will be able to hop over this property line.

The sleeper deal to keep an eye on is Screenvision, the in-cinema ad firm currently being shopped. I've said it before, but this is one ad-supported business poised to grow even in this parched landscape: You have big screens, big speakers, a captive audience, and networks linking many screens together. Screenvision trails U.S. category leader National CineMedia, but a new and motivated owner could heat up the space significantly.

See you in the springtime. | BW |

> **The question is: Do you have content people will pay meaningful sums for? Most newspapers, magazines, and radio don't**

BUSINESSWEEK.COM

For Jon Fine's blog on media and advertising, go to businessweek.com/innovate/FineOnMedia.

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Radio's Cautionary Tale

Many major radio companies borrowed big to bulk up in the years preceding the bust of 2008. Now they're forced to renegotiate their deals with bankers and bondholders, *The Wall Street Journal* recently reported in "Radio Firms Beg Lenders For Mercy."

For this and other stories about the radio industry, go to **bx.businessweek.com/radio-broadcasting/**



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Source: Mendelsohn Affluent Survey 2008



Microsoft Steps Up Its War on Hackers

It's offering free antivirus software that is simple to install and operated without a hitch

Microsoft thinks everyone who runs Windows should be using antivirus software. I can just hear the cynics saying: "They ought to know—it's their buggy software the hackers are exploiting." In fact, over the past five years, Microsoft has made huge strides in protecting its systems against attacks. Now it's moving to the next level.



Microsoft works hard to make sure its programmers write secure code. But the company's executives know that even with the most diligent process, there will always be flaws that provide openings for the bad guys. They also know that an unprotected system is a peril not only to its owner, who risks the loss of user names, passwords, and other vital information, but also to the community. A large percentage of the malicious programs out there are designed to capture PCs so they can be used to spew spam or launch attacks.

A few years ago, Microsoft tried, unsuccessfully, to get into the paid security business with a service called OneCare. Now management has decided that if they can't sell it, they will give it away. Microsoft Security Essentials is a basic antivirus program that scans your system for malware, checks files that you bring into your computer through downloads or media such as flash drives, and tries to block sneak downloads from hostile Web sites. It works with Windows 7, Vista, and XP and is available for download now as a test version. The final product is due before yearend.

Giving away antivirus programs is nothing new; AVG, Avast!, and others have long provided free programs. But Microsoft throwing its weight and marketing might behind such software could make a big difference.

I tried Security Essentials on several systems and found that it installed easily and worked flawlessly without noticeably slowing performance. The German lab AV-Test ran its standard tests on Security Essentials and declared it to be "very good" compared with competing products.

At the same time, I don't think Security Essentials is about to drive paid offerings from the likes of Symantec and McAfee off the market. These companies sell a variety of security products and services ranging from around $40 to $80 a year for up to three computers, and all are far more comprehensive than Security Essentials. The for-pay offerings include firewalls, anti-phishing defenses, parental controls, and in some cases data backup services.

Unfortunately, computer makers may not install Security Essentials on new PCs because of ties with antivirus companies

Still, I have grown disenchanted with these heavyweight packages. Many of the features duplicate what is already built into operating systems and browsers. Vista and Windows 7, for example, have solid parental controls, and Internet Explorer 8 and Firefox 3.5 have defenses against both phishing attacks and "drive-by downloads" of malware from Web sites.

While the firewalls included in the paid products offer much more detailed control than the built-in Windows firewall that Security Essentials relies on, the overwhelming majority of users never touch these settings. And Symantec's Norton Internet Security, which I use on my home Windows systems, has recently developed the annoying habit of demanding that I reboot my system to install updates a couple times a week.

Unfortunately, I don't expect computer makers will install Security Essentials on new PCs. Antivirus software makers pay to have trial versions of their programs loaded. With margins tight, manufacturers want that revenue. Trouble is, many customers never renew after the 30- to 90-day trial period runs out and are thus left unprotected. Microsoft's "good enough" offering is exactly that, and it marks important progress in the fight to keep computers safe. |BW|

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ILLUSTRATION BY CHRISTOPH HITZ | PHOTOGRAPH BY BRAD TRENT

Can Entrepreneurs Tame the Mideast?

The theory is that a flourishing Muslim bourgeoisie will usher in democracy. That seems like wishful thinking

Vali Nasr, an eminent Middle East scholar, offers a sunny vision of that region's future that should interest anyone concerned with global business or politics. In *Forces of Fortune: The Rise of the New Muslim Middle Class and What It Will Mean for Our World*, he argues that entrepreneurial, religiously conservative contingents in such countries as Turkey, Pakistan, and Iran can propel the Middle East into a democratic and prosperous 21st century. If only those arguments were more persuasive.

Iranian-born Nasr teaches at Tufts University's Fletcher School of Law & Diplomacy. His 2006 book, *The Shia Revival,* ably explained the origins of sectarian violence in Iraq after the U.S. invasion. And he has advised Richard Holbrooke, special envoy for the U.S. to Pakistan and Afghanistan. In *Forces of Fortune*, Nasr asserts that the West, and especially the U.S., has focused on opposing extremism and missed a shot at effecting real change by nurturing a nascent bourgeoisie of bankers, manufacturers, and scientists.

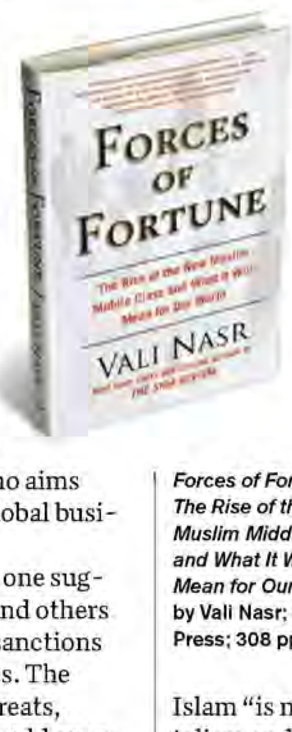
It's an appealing idea, but as soon as Nasr's theory encounters reality, it begins to crumble. Take Iran, which the author knows best: Members of the middle class, including entrepreneurs, helped lead protests there against the rigged reelection in June of President Mahmoud Ahmadinejad. Nasr strains to maintain his optimism, despite the brutal response of the theocratic regime and its thugs. "Change comes only slowly," he writes. "There will be many ... setbacks." Understatement aside, the bloody outcome in Tehran undercuts Nasr's notion that commercial energy will erode Middle Eastern authoritarianism anytime soon.

But Nasr interprets the stifled dissent in Iran as a crack in the mullahs' defenses, a wedge for the campaign for greater openness. As for who would lead the resistance, Nasr nominates capitalists such as Parviz Aghili. Aghili got his PhD in the U.S., cut his teeth at HSBC, and founded the 55-branch Karafarin Bank. Nasr says Karafarin is the most competitive of Iran's 10 private banks, thriving despite rules favoring government banks. One of the best ways to weaken Ahmadinejad and bolster the economy, Nasr argues, is to help Aghili, who aims to integrate Iran into the global business system.

Sounds good. But Nasr's one suggestion for helping Aghili and others like him is to end Western sanctions that hurt Iranian businesses. The author opposes military threats, suggesting that the U.S. should open a diplomatic line to Ahmadinejad. Perhaps President Obama can charm Iran out of its desire for a nuclear weapon. But that seems less likely after June's election fiasco. Short of sanctions, it's not clear how the West can apply real pressure.

Pakistani reformers helped usher in a civilian government, but the Taliban now runs amok and the economy is failing

Moving to Pakistan, Nasr is, if anything, less convincing. Yes, as he says, émigré Pakistanis have thrived in business abroad. But within Pakistan, the only encouraging proof of capitalist pushback he can identify is the lawyer-led movement that helped end the military dictatorship of Pervez Musharraf. The lawyers also helped bring in an elected government. But that government can barely contain the Taliban and its extremist allies, or the pernicious Pakistani security forces. Sadly, for his pro-capitalist stance, Nasr has to admit that "the economy has begun to unravel."



***Forces of Fortune: The Rise of the New Muslim Middle Class and What It Will Mean for Our World* by Vali Nasr; Free Press; 308 pp.; $26**

His one striking example of commerce aiding progress is Turkey, where the religiously conservative Justice & Development Party has pointed the nation toward a rosier future. Nasr gives a tour of the city of Kayseri, 550 miles east of Istanbul. Kayseri exports furniture and denim. Its food products giant, Ulker, orchestrates an empire that includes Godiva Chocolatier. The place bustles.

Even though Kayseri is a devout city, its version of Islam "is not hard-edged fundamentalism and even less so an echo of extremism that inspires radicalism in the Arab world. Islam here is conservative, but pro-Europe, pro-democracy, and above all pro-capitalism."

Nasr demonstrates how varied Islam—and Muslims—can be. But he doesn't explain how Turkey's successes can translate to countries where there are great business traditions but also religious and ideological movements that have priorities at odds with unleashing capitalism's invigorating forces. |BW|

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R&D'S FUTURE

GOING BACK TO BASICS

"How Science Can Create Millions of New Jobs," part of our Cover Story on the future of R&D (Sept. 7), called for a renewed focus on basic research, arguing that scientific innovation has historically spawned entire U.S. industries. Readers didn't disagree but pointed out what they saw as obstacles to reinvigorating such research—everything from failures in education to the demoralizing effect of having skilled jobs outsourced or given to H-1B visa holders.

The article fails to point to a root problem: Our educational system and our families are not doing a good job. Too many children are spoiled. Too many are given good grades for nothing stellar, and too few are inspired in science and math or have a strong work ethic.

Robert Mitchell
GAITHERSBURG, MD.



With all the skilled jobs being offshored to India and China, why bother? No one wants to go into the sciences, rack up huge student-loan debts, and then see their jobs shipped overseas—or their salaries suppressed by H-1B visa holders.

Screen name: PJL

I disagree with the article's contention that one difficulty with basic research is that "science is a crapshoot." I have been involved with science and engineering in my 21-year career at Xerox. Both, especially engineering, can be made less risk-prone by the use of statistical experimental design. The biggest roadblock to employing this method of scientific research is the stubborn pride of the "high IQ" PhDs who think they know better.

Thomas Barker
WEBSTER, N.Y.

The article says Bell Labs has shrunk from 30,000 employees in 2001 to 1,000 today, but this is an apples-to-oranges comparison. Only 1,500 of the 30,000 were researchers. In fact, at no time did Bell Labs ever employ more than 3,200 researchers. The chart accompanying the article implies that Bell Labs' innovations came to a halt in 1978, ignoring a string of recent inventions such as in optical networking and mobile broadband technology at the core of today's networks. The culture and focus on innovating in the Labs has not changed, nor has the caliber of research and researchers. What's more, research networks and partnerships greatly extend our reach and amplify our impact.

Jeong Kim, President
Alcatel-Lucent Bell Labs
MURRAY HILL, N.J.

EXECUTIVE PAY

SEND A MESSAGE TO OVERGENEROUS BOARDS

"CEO Pay: Is It Still Out of Sync?" (New Business, Sept. 7), about CEOs getting outrageous pay while their companies lose money and lay off workers, has spurred me to action. I'll be sure not to own the stock or buy the products of the companies mentioned. If others do likewise, maybe the companies' boards will attempt to align CEO compensation with good performance and responsible leadership.

Chris Smith
WYNDMOOR, PA.

FINANCE

LEVERAGE DOESN'T ALWAYS PAY

Regarding "Are Banks Playing It Too Safe?" (New Business, Sept. 7): Is there any evidence that banks obsessed with maximizing leverage generate better risk-adjusted returns than more conservatively managed banks? If so, I'd like to see it.

Alec McAndrew
NOVATO, CALIF.

THE FED

INTEREST RATE SLEIGHT OF HAND

Is Fed Chairman Ben Bernanke a magician ("Low Rates as Far as Bernanke Can See," New Business, Sept. 7)? Washington lends banks billions as he keeps interest rates at almost zero. Banks lend at much higher rates, making money hand over fist, then pay back the government with fanfare. My granddaughter could do this trick blindfolded.

Robert Harris
PLANTATION, FLA.

CORRECTIONS & CLARIFICATIONS

"Best Places to Launch a Career" (Cover Story, Sept. 14) mistakenly referred to professional services firm Deloitte as Deloitte & Touche.

A correction in the Sept. 14 issue repeated an error in "The Most Powerful Banker You've Never Head Of" (In Depth, Sept. 7). Citi did not hire Edward J. Kelly in 2008 to head up strategy. He was hired to run the Alternative Investments unit.

FRITZ GORO/TIME LIFE PICTURES/GETTY IMAGES

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In Volatile Times, Agility Rules

Flexible capacity and worker skills are essential, but in a context of strategic clarity

Over the years managers have developed tools and techniques to overcome challenges ranging from inconsistent quality to stagnant productivity. (Think Six Sigma, Total Quality Management, and just-in-time supply chains.) Now what they need is a system for addressing volatility. How does a chemical company, for example, cope with oil prices that bounce from $50 a barrel to $150 and back in 18 months?

And commodity prices are just one factor in the volatility we're seeing in the global business environment. The U.S. has a new Administration with a fast-evolving regulatory posture. We may soon be saying the same thing about Japan and Germany. Terrorism and pandemics pose threats of major disruptions. Changes in consumer sentiment, such as "going green" or shunning conspicuous consumption, can rewrite established patterns of demand in a remarkably short time—just ask automakers. Volatility is here to stay.

What this does is force managers to harmonize two critical capabilities: on the one hand, strategic clarity and consistency; on the other, agility and resilience in operations. This may seem counterintuitive, but organizations can handle extreme change only when they can address it within a clear strategic framework. Otherwise, companies can only wait and react.

Some aspects of managing in a volatile environment, such as focusing on operational efficiency and staying liquid, are givens. But more important are the abilities to scale up and down and reconfigure resources rapidly. Here, there are lessons to draw from volatility-prone India, with its shifting regulations, spurts of growth, capital shortages, and challenging supply base.

Scaling up and down quickly requires a renewed focus on the breakeven point of businesses. Can a company break even at 30% to 40% of capacity utilization? If the answer becomes yes, this creates a lot of room for dealing with shifts in demand. But to get to that point, managers have to focus on capital intensity and fixed costs.

Not long ago, Airtel, India's largest telecom carrier, with 100 million subscribers, saw opportunities for growth but was starved for cash. Typically, telecom carriers invest in capacity, but Airtel outsourced IT management to IBM and leased network capacity from Ericsson and Nokia. By paying for only the capacity it needed, Airtel converted fixed costs into variable costs. So the company shrank its capital intensity and gained the ability to scale up rapidly. It can also scale down without the penalties a capital-intensive telecom carrier would face. Airtel may now be the world's lowest-priced carrier (at less than 2¢ a minute) and is one of the most profitable.



Indian IT providers have to hit a number of moving targets. As customer requirements change, the mix of skills needed to serve them changes, too. These companies must also expand the range of services they offer to capture emerging business opportunities. Further, they have to juggle an overlapping series of projects of differing durations. Many of these companies have found ways to handle all this flux without painful restructuring.

One of their rules of thumb guards against sudden shifts in demand: Don't allow a single customer to contribute more than 5% of revenues. Many IT companies make it a goal to draw clients from a variety of sectors. Managing their client portfolios this way offers a first level of protection.

To better handle the constant project turnover, employees are cross-trained in many different skills. This requires an arsenal of training programs. Employees are regularly tested, and the hallmark of the best of them is the ability to learn quickly.

Having this much flexibility in a staff, and within each staffer, forces these companies to equip their managers with instant access to data on what each employee can do and where they are—physically and in terms of the finish date of their current assignment. All employees know they will be moved from one assignment to another, and in many cases across the world. It becomes the cultural expectation.

In this volatile world, more and more companies will strive to become "Velcro organizations" in which people and capacity can be rearranged and recombined creatively and quickly without major structural change. The winners won't stop focusing on quality, cost, and efficiency, but they'll be paying a lot more attention to agility, too. | BW |

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Jack and Suzy Welch are off this week.

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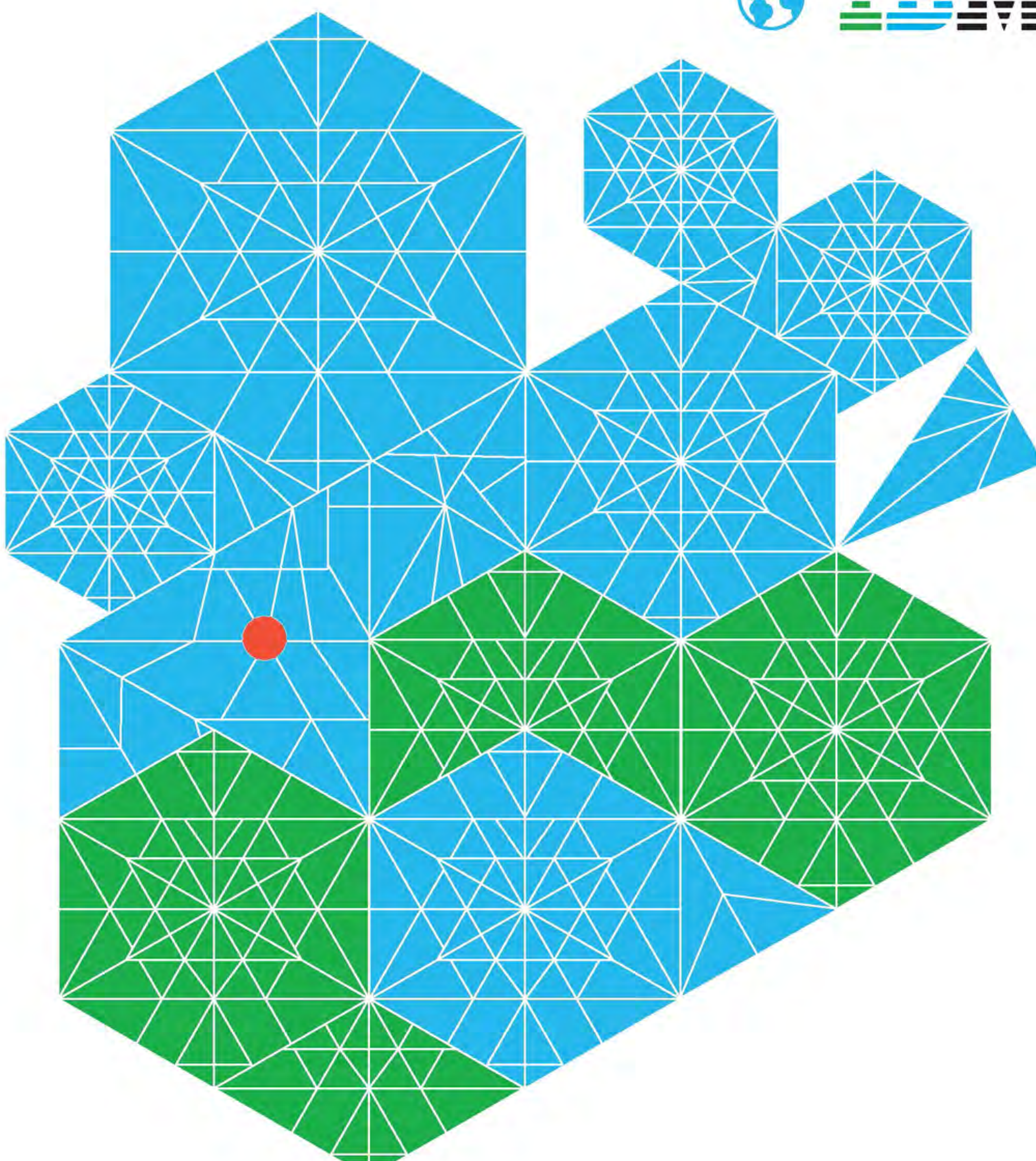
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